89-1503

NO.

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

PHILADELPHIA STOCK EXCHANGE, INC.,

Petitioner,

v.

CHICAGO MERCANTILE EXCHANGE,
BOARD OF TRADE OF THE CITY OF CHICAGO,
SECURITIES AND EXCHANGE COMMISSION,
THE INVESTMENT COMPANY INSTITUTE,
THE OPTIONS CLEARING CORP.,
AMERICAN STOCK EXCHANGE, INC.
and CHICAGO BOARD OPTIONS EXCHANGE, INC.,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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Question Presented

Did the Court of Appeals err in drawing a line between the jurisdiction of the Securities and Exchange Commission ("SEC") and the Commodity Futures Trading Commission, based on an unlimited definition of "futurity", which encompasses all instruments where realization of value is delayed, even by as little as one day, thereby denying the SEC its Congressional grant of jurisdiction over innovative securities instruments?

List of Parties

The parties to the proceeding in the court whose judgment is sought to be reviewed are:[1]

1. Petitioner Philadelphia Stock Exchange, Inc.[2]
2. Respondent Chicago Mercantile Exchange.
3. Respondent Board of Trade of the City of Chicago.
4. Respondent Investment Company Institute.
5. Respondent Securities and Exchange Commission.
6. Respondent The Options Clearing Corporation.
7. Respondent American Stock Exchange, Inc.
8. Respondent Chicago Board Options Exchange, Inc.

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[1] The Commodity Futures Trading Commission was not a party to the action below, but did file a brief as *amicus curiae* in support of the petition for review sought by respondents Chicago Mercantile Exchange and Board of Trade of the City of Chicago.

[2] The stock of petitioner is not publicly traded and control of petitioner is vested in its members. The subsidiaries of petitioner (other than wholly-owned), as defined in Supreme Court Rule 29.1, are the Center for Currency Options, Inc. and the Philadelphia Board of Trade, Inc.

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Respondents.

PETITION FOR A WRIT OF CERTIORARI

Petitioner respectfully requests that a writ of certiorari be issued to review the decision and judgment of the United States Court of Appeals for the Seventh Circuit entered on August 18, 1989, which set aside two related orders of the Securities and Exchange Commission. The two orders approved, respectively, rules changes by petitioner that provided for the trading of an investment instrument called a Cash Index Participation and rules changes by respondent The Options Clearing Corporation that provided for the issuance and clearing of transactions in the Cash Index Participation.

Opinions Below

The opinion of the Court of Appeals (reproduced in the Appendix at A1),[1] including the Court of Appeals' opinion on denial of rehearing and rehearing en banc (reproduced in the Appendix at A108), is reported at 883 F.2d 537. The orders of the Securities and Exchange Commission set aside by the Court of Appeals are contained in Securities Exchange Act Release No. 26709 (54 Fed. Reg. 15,280) (reproduced in the Appendix at A26) and Securities Exchange Act Release No. 26713 (54 Fed. Reg. 15,575) (reproduced in the Appendix at A84).

Jurisdiction

The judgment of the Court of Appeals was entered on August 18, 1989 (A1-25). By order and opinion dated October 23, 1989, the Court of Appeals denied a timely petition for rehearing and suggestion for rehearing en banc (A108-111).[2] On January 17, 1990, this Court granted petitioner's application (Application No. A-513) for an extension of time to file this petition, and extended petitioner's time to file this petition to March 26, 1990. This Court has jurisdiction to review the judgment of the Court of Appeals by writ of certiorari pursuant to 28 U.S.C. § 1254(1)(1988).

Constitutional and Statutory Provisions Involved

This case involves Section 2 of the Commodity Exchange Act, as amended (7 U.S.C. §§ 2, 2a (1988)) and Sections 3(a)(10) and 25(a) of the Securities Exchange Act of 1934, as amended (15 U.S.C. §§ 78c(a)(10), 78y(a) (1988)).

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[1] Prior to the filing of this petition, respondents The Options Clearing Corporation (the "OCC"), American Stock Exchange, Inc. ("AMEX") and Chicago Board Options Exchange ("CBOE") filed a joint petition for a writ of certiorari in this action. Pursuant to the instructions of the Clerk of this Court, petitioner and OCC, AMEX and CBOE have jointly prepared an appendix that has been filed with the OCC, AMEX and CBOE petition and is incorporated herein by reference. Pages of the appendix shall be cited herein as "A___".

[2] Two judges of the Court of Appeals, Judges Cudahy and Ripple, voted in favor of rehearing en banc. A110-11.

The pertinent portions of these provisions are reproduced in the Appendix at A119-21.

Statement of the Case

On April 11, 1989, the Securities and Exchange Commission (the "SEC") issued an order approving an application of petitioner Philadelphia Stock Exchange, Inc. ("PHLX") to list and trade an instrument known as the Cash Index Participation (the "CIP").[3] A84-107. The SEC simultaneously issued an order approving the application of the OCC to act as issuer and clearing agent for the CIP. A108-111.

The CIP was a new and unique instrument, designed to allow investors to obtain the benefits of owning a diversified portfolio of stocks without requiring them to incur the substantial transaction costs of obtaining each stock in the portfolio. A68-70. The CIP was also seen as filling a need, identified by several commissions established in the aftermath of the October 1987 stock market crash, for a "market-basket" security that would help reduce the price volatility and market uncertainties caused by trading between stock index futures and the component stocks of the underlying index. A67-68.

The CIP was an instrument of perpetual duration that allowed an investor either to buy or sell the equivalent of a market basket of stocks, represented by an "index" of underlying stocks,[4] by taking either long or short positions in the CIP. A2-3. The purchaser or "long" would, upon opening his position, pay to the seller or "short" the full purchase price of the CIP. In return for the payment of the purchase price, the long would receive certain rights under the CIP,

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[3] The SEC's order also approved the listing and trading of similar instruments by respondents AMEX and CBOE called, respectively, Equity Index Participations and Value of Index Participations. The Court of Appeals referred to the CIP and the other similar instruments by the generic term "Index Participation" or "IP". A2.

[4] There were two CIPs representing two different indexes of stocks: the S & P 500 CIP represented the Standard & Poor's 500 Stock Index, and the Blue Chip CIP represented an index of designated high capitalization blue chip stocks. A32-33.

including the right to receive quarterly dividend-equivalent payments equal to the regular cash dividends that would be received by a holder of the stocks that composed the CIP index and the privilege to exercise a "cash-out" under which the long could, on a daily basis, elect to liquidate his position in return for 99.5% of the value of the underlying index, as of the close of business the following day.[5] A27-28. Although the long did not possess any voting rights, the CIP was designed to replicate all the economic characteristics of the ownership of a portfolio of stocks. A27, 49-50.

The short had obligations that were a mirror image of the long's rights. In return for receiving the full purchase price of the CIP upon opening his position, the short undertook to make dividend equivalent payments to the long and to pay 99.5% of the value of the underlying index (or 100% if exercise occurred on the designated day each quarter) to a long exercising the cash-out privilege. A38-39. Each time a long exercised his cash-out privilege, a short would be chosen to pay the value of his position to the long. A4, 31.

CIPs would be traded daily on the floor of PHLX. Thus, both the long and the short could also liquidate a position by trading. The short would purchase a CIP, thereby cancelling out the original short position, or the long would sell a CIP, thereby cancelling out the original long position. A4.

The CIP, however, was never given a fair chance to prove its utility in the marketplace. Immediately upon its approval, respondents Chicago Mercantile Exchange ("CME") and Board of Trade of the City of Chicago ("CBT") filed a Petition for Review in the United States Court of Appeals for the Seventh Circuit pursuant to Section 25(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), 15 U.S.C. § 78y(a) (1988), asking the Court of Appeals to set aside the SEC's orders and to block the trading of IPs on any exchange. A5. The CME and CBT

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[5] Once each quarter, there was a designated day on which a long could cash-out for the full value of the underlying index. A27-28. The AMEX and CBOE instruments provided only a privilege to cash-out once each quarter or semi-annually, and not for a daily cash-out. A28-30.

took the position that, even though the CIP was explicitly designed to replicate the economic characteristics of stock ownership, the CIP and similar instruments should be regulated by the Commodity Futures Trading Commission (the "CFTC"), rather than by the SEC, the agency that regulates stock transactions.[6] A5.

The United States is unique among market economy countries in dividing responsibility for regulating financial instruments between two agencies. The SEC regulates the trading of securities pursuant to the Exchange Act, and the CFTC regulates futures contracts pursuant to the Commodity Exchange Act of 1974, as amended (the "CEA"). 7 U.S.C. § 1, *et seq.* (1988). It has been argued that this division of regulatory authority fosters competition among financial markets and serves the interest of the investing public. A13. However, as the Court of Appeals recognized in this action, this divided authority can be used by one segment of the financial industry to veto innovations proposed by another segment of the industry. A22. Although no instrument like the CIP has ever been proposed for trading on a futures exchange, either before or after the Court of Appeals' decision, the CME and CBT took the position that such an instrument could not be offered to the public by a securities exchange. A6.

The Court of Appeals determined that the CIP was, in fact, a new type of instrument that did not fit precisely within the definition of either a security or a futures contract. "We must decide whether tetrahedrons belong in square or round holes." A2. However, the Court of Appeals, taking a broad view of the CFTC's jurisdiction over futures contracts, then determined that any instrument containing

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[6] Respondent Investment Company Institute (the "ICI") also filed a Petition for Review, arguing that the CIP, although properly within the SEC's jurisdiction, constituted shares in an investment company as defined in the Investment Company Act of 1940, as amended (15 U.S.C. § 80a-1, *et seq.* (1988)), and had not been properly approved in accordance with that act. A5. Because the Court of Appeals held that the CFTC was the proper regulatory authority for the CIP, the court had no occasion to rule on the issue raised by the ICI. A25.

an element of futurity, as expansively viewed by the Court of Appeals, is subject to the CFTC's jurisdiction, in spite of the instrument's fundamental security characteristics. A22.

Consistent with the unbalanced deference that it accorded to the CFTC's jurisdiction, the Court of Appeals held that the CIP possessed "futurity" because the holder of a CIP does not have the right to realize the value of his investment instantaneously. A17. Consequently, PHLX was compelled to halt trading in the CIP, and the investing public was wrongly deprived of the benefits of an innovative and useful instrument. A25.

Reasons for Granting the Writ

The net effect of the Court of Appeals' decision is to call into question whether any new and innovative financial products can be developed by or traded on securities exchanges and, in many cases, be traded at all in the United States. The Court of Appeals' deference to CFTC jurisdiction, combined with its overbroad definition of futurity, has created a situation where any financial instrument that is not precisely identical to instruments already traded on securities exchanges will likely be found to possess the element of futurity and therefore placed under CFTC jurisdiction. Thus, securities exchanges, such as PHLX, will be wrongly denied the ability to participate in the development of innovative financial instruments, and the public will be denied the benefit of market innovation that is sorely needed.

The CEA contains a very broad definition of the term "commodity", and requires that contracts for "future delivery" of a commodity be traded exclusively on markets designated by the CFTC. 7 U.S.C. §§ 2, 2a (1988). As a result, under the Court of Appeals' expansive definition of futurity, almost any transaction, regardless of the item traded, can be found to possess futurity, if delivery of the item does not occur instantaneously. *See* A16. The broad definition of the term commodity contained in the CEA, combined with a broad definition of the term futurity, as put

forward by the Court of Appeals, could transform most commercial transactions into contracts for the future delivery of a commodity that can only be traded on futures exchanges. *See* 7 U.S.C. §§ 2, 2a (1988).

Therefore, viewing the Court of Appeals' decision with the broadest possible scope, the decision calls into question the continued viability of flourishing financial markets, always thought to be beyond the scope of the CEA, since they could now be viewed as nothing more than illegal futures exchanges. At a minimum, the Court of Appeals' decision effectively destroys the ability of these markets to meet investors' developing needs because any new instruments developed will be found to possess futurity, as defined by the Court of Appeals. Indeed, the Court of Appeals implicitly recognized that its decision gives one segment of the financial industry (futures exchanges) the power to destroy useful products (such as the CIP) for reasons having nothing to do with the new product's ability to survive in a free and competitive marketplace and to serve the needs of the investing public. A22.

It was clearly never Congress' intent, in dividing jurisdiction between the SEC and CFTC, that all financial innovation be entrusted to the CFTC. Yet, if the Court of Appeals' decision is allowed to stand, such a result is almost inevitable.

I. The Seventh Circuit's Decision Has Erased Any Meaningful And Principled Distinction Between Futures Contracts And Securities

Central to the Court of Appeals' finding that the CIP falls within the exclusive jurisdiction of the CFTC was the court's determination that the CIP possessed the element of futurity. A17. By virtue of its decision, the Court of Appeals, in effect, has held that any investment instrument whose value cannot be realized until a future time possesses futurity and therefore is a "futures contract".[7] The Court of

[7] The Court of Appeals also stated that the CIP looked like a security to a long, but looked like a futures contract to a short. A3. That observation was mistaken. In fact, a short on the CIP is fundamentally in the same

(footnote continued on next page)

Appeals held that the CIP had the characteristic of futurity because, although the CIP long discharges all his obligations under the CIP contract upon purchasing the CIP, the long cannot compel a short to pay him for the value of his position until a future cash-out date. A16-17.

However, futurity, as defined by the Court of Appeals, could be ascribed to virtually any financial instrument traded in an active market. Indeed, stocks, bonds and many other investment vehicles, which are concededly not futures contracts, carry with them no right to the current value of the instrument and allow an investor only the right to realize the value of the instrument on a future date. Thus, the Court of Appeals' definition eliminates any distinction between a futures contract and a security, and leaves nothing that can be called solely a security.

Given the Court of Appeals' infinite expansion of the concept of futurity, literally any security or investment could be said to possess futurity and be categorized as a futures contract. For instance, the holder of stock has no right to compel anyone, including the company whose stock the investor owns, to pay him the current value of the stock

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(footnote continued from preceding page)

position as a short-seller of stock, who borrows stock from a third-party, and not a short on a futures contract. The short-seller of stock must make dividend equivalent payments to the lender of the stock, *see* F. Fabozzi & F. Zarb, *Handbook of Financial Markets: Securities, Options, Futures* ("Fabozzi & Zarb") at 283-84 (1981), just as a CIP short makes these payments to the long. A short on a futures market makes no such payments. 1 P. Johnson & T. Hazen, *Commodities Regulation* ("Johnson & Hazen") § 1.10 at 41 (2d ed. 1989) (title to underlying commodity does not pass at opening of position). Likewise, a short-seller of stock receives full payment for the stock when the sale occurs (subject to a settlement period), Fabozzi & Zarb at 283-84, just as a CIP short receives full payment for his position on the day it is open. Payment on a futures contract short position is made on the day of delivery, when the contract expires, not on the day the position is opened. 1 Johnson & Hazen §1.17. Consequently, to the extent that the Court of Appeals based its decision on the perception that a CIP short was in the same position as a futures contract short, the Court of Appeals erred.

upon his demand. A9.[8] The stockholder must either trade out of his position, through a sale to another party on some date subsequent to the stock's acquisition, or alternatively wait for the future liquidation of the company to enforce his rights to the stock's current value. Consequently, under the Court of Appeals' definition, stock manifests the same element of "futurity" as a futures contract or a CIP. A16 ("[n]either the long on the IP nor a long on a futures contract can compel the short to *pay* current value . . . ." (original emphasis)).

The illogic of the Court of Appeals' definition of futurity is, however, best illustrated by its treatment of the CIP daily cash-out provision. Unlike the other IP instruments considered by the Court of Appeals, the CIP allowed a long to cash-out on a *daily* basis, not quarterly or semi-annually; thus, in addition to the ability to liquidate the position on the trading floor, a long could exercise his cash-out rights immediately after establishing his position. A27-28.

In its decision denying a rehearing, the court quoted from PHLX's reply brief in opposition to the CME's and CBT's Petition for Review:

> [I]t is important to note that [the CIP] has a daily, not quarterly, cash-out provision. Therefore, assuming *arguendo* as true the CME's and CBT's notion that a quarterly cash-out carries with it an element of futurity, a daily cash-out cannot be equated with a futures contract's quarterly expiration. Even in a stock transaction, the settlement period for delivery of the stock is 5 days. A daily cash-out, which is a feature unique to [the CIP], eliminates any element of futurity.

A110. Even the CFTC has, at times, recognized that a short delay in realizing the value of an instrument does not constitute futurity. *See* CFTC Office of the General Counsel,

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[8] Indeed, a transaction on the New York Stock Exchange ("NYSE") involves a settlement period of up to 5 days. NYSE Rule 64. Thus, a purchase of stock actually calls for delivery on a date in the future every bit as much as the daily cash-out of the CIP.

Interpretative Letter No. 85-2, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,673 at 30,857 (Aug. 6, 1985) (determining that certain bank transactions lack the "element of futurity", even though the transactions involve transfer of title two days after the initial transaction). Yet, the Court of Appeals improperly concluded that the daily cash-out provision also possessed futurity.[9] A110.

If the concept of futurity is to result in a principled distinction between futures contracts and stock and other securities, there is an essential characteristic that the Court of Appeals must have omitted from its stated definition of futurity. Although the Court of Appeals held otherwise, it has always been part of the traditional and accepted definition of a futures contract that they are *bilateral* contracts. That is, that futures contracts do not defer the exercise of some rights to a future date (as do stocks and CIPs), but that futures contracts defer the accrual of *all* rights and obligations, both on the short and long side, to a fixed future date:

> Futures trading occurs in *executory contracts* as yet uncompleted, representing an exchange of mutual promises to conclude a sale later on specific terms. Acquisition of a futures contract, therefore, leaves title and ownership of the underlying commodity exactly where it was before the contract was entered. Title will not pass unless and until the futures contract is fully performed by both parties: the seller by delivering what he has promised; the buyer by tendering the *full* purchase price.

I Johnson & Hazen § 1.10 at 42 (original emphasis).

The Court of Appeals conceded that CIPs were not bilateral, but rejected the argument that futurity combined with

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[9] The Court of Appeals so concluded solely because the daily cash-out occurs at 99.5% of index value, rather than 100%. A110. This is a distinction without a difference. If PHLX had set the value of the CIP at 50% of index value it would still represent a *present* interest, regardless of the amount. Quarterly cash-out at 100% of index value is better viewed as a premium paid to encourage investors to utilize market transactions (at full index value) rather than utilizing the daily cash-out. A27-28. It is therefore wrong to call the daily cash-out a "cash-out at a penalty." A110.

bilateralism is the defining characteristic of a futures contract. A16-17.[10] In so doing, the Court of Appeals effectively transformed virtually all financial instruments into futures contracts, thereby stripping the SEC of its jurisdiction over new financial instruments and transferring all jurisdiction over such instruments to the CFTC. The Court of Appeals erred in abandoning the proper definition, which, if applied, would have required affirmance of the SEC's order authorizing CIPs.

II. Congress Intended That Securities Exchanges Play A Role In The Development Of Innovative Financial Products

There is no statutory definition of a futures contract. *See* 7 U.S.C. § 2 (1988). Nonetheless, use of a definition of futurity that frustrates Congressional intent is certainly neither justified nor proper. Here, that is exactly what happened. The Court of Appeals adopted a definition that is so broad that it denies the SEC its Congressionally mandated right to oversee the development of innovative securities instruments.

Congress has vested both the SEC and CFTC with jurisdiction over different types of financial instruments: securities and futures contracts. In so doing, Congress has

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[10] The Court of Appeals' rejection of bilateralism is especially curious because, prior to this decision, the CFTC had always taken the position that bilateralism was an essential element of a futures contract. In a report to the Senate Agriculture Committee, dated May 16, 1989 (the "CFTC Report", which was accepted into the record by the Court of Appeals as a publicly available document (A7)), the CFTC addressed the question of CIP jurisdiction. In response to the SEC's assertion that a CIP lacked bilateralism, the CFTC identified bilateralism as "a second essential element of a futures contract . . ." and attempted to show how the CIP was a bilateral contract. CFTC Report at 10. The CFTC reiterated this point to the Court of Appeals in its *amicus* brief.

In its decision, however, the Court of Appeals correctly held that the CIP lacked bilateralism. A16. Nevertheless, rather than deferring to the CFTC's well-established definition, as it should have, the Court of Appeals chose to abandon it and to apply a boundless definition of futurity that permitted the Court of Appeals to find that a CIP was subject to CFTC jurisdiction. A16-17.

expressly preserved the authority of the SEC to maintain jurisdiction over securities and the development of innovative securities instruments.[11]

Conflicts between the SEC and CFTC over stock-index based instruments have arisen in the past, and Congress has acted to maintain the balance between the SEC and the CFTC. A11-13. In the aftermath of *Chicago Board of Trade v. SEC*, 677 F.2d 1137 (7th Cir.), *vacated as moot*, 459 U.S. 1026 (1982), Congress addressed the jurisdictional conflict between the SEC and CFTC over stock-index based products by enacting certain legislative proposals that are known as the "Johnson-Shad Accord". *See* Pub. L. No. 97-444, 96 Stat. 2294 (1983); *see also* CFTC and SEC Jurisdictional Agreement: Proposed Legislation, [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,332 (Feb. 2, 1982); A11-12. There is no question that in enacting the Accord, Congress fully intended that the SEC would continue to play a critical role in the development of new instruments, including index-based instruments:

> Certain national securities exchanges have proposed to trade, as a package, groups of individual stocks. Since the SEC has the authority to regulate trading in the individual securities composing the group, the Committee believes that it has ample authority to regulate trading in that group. This bill would provide an express statement of that authority.

H.R. Rep. No. 626 (Part 1), 97th Cong., 2d Sess. 10 (1982), *reprinted in* 1982 U.S. Code Cong. & Admin. News 2780, 2788.

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[11] When Congress earlier gave the CFTC exclusive jurisdiction over futures contracts, it expressly added a provision to the CEA to make perfectly clear that the CFTC's exclusive jurisdiction over futures contracts should not be seen as restricting the SEC's role in the development of financial products. That provision, known as the Savings Clause, provides that "[N]othing contained in this section shall (i) supersede or limit the jurisdiction at any time conferred on the Securities and Exchange Commission . . . ." 7 U.S.C. § 2 (1988).

Likewise, the House Committee on Agriculture, which oversees the CFTC, recognized the continuing role of the SEC in these markets:

> The [House Committee on Agriculture] has long recognized and accepted the inherent differences between the futures industry and the securities industry and endorses the concept of separate regulation. Basically, the CFTC will continue its traditional role of regulating markets and instruments that serve a hedging and price discovery function while the SEC will primarily regulate markets and instruments with an underlying investment purpose.

H.R. Rep. No. 626 (Part 2), 97th Cong., 2d Sess. 3 (1982), *reprinted in* 1982 U.S. Code Cong. & Admin. News 2780, 2793.

The Court of Appeals' definition of futurity ignores Congress' intent, and would destroy the balance between the two agencies. Under the court's decision, any instrument that involves the deferral of the right to realize the value of the instrument to a future moment in time could be a futures contract and, therefore, beyond the scope of the SEC. *See* A16. Consequently, allowing the Court of Appeals' decision to stand will fundamentally and improperly alter the delicate balance struck between two federal agencies by Congress, as well as deprive the investing public of the benefits of innovation and competition.

This consequence is all completely unnecessary. A principled and more narrow definition of futurity based on bilateralism, which recognizes that futures contracts are unique financial instruments, would both preserve the authority of the CFTC with respect to the instruments that belong within its jurisdiction and leave the SEC free to foster innovation within its jurisdiction.

It is inconsistent with Congressional intent to define the term futurity, a term not even used in the CEA or the 1982 legislation, so broadly as to undo all the work done by Congress to achieve a proper balance between the CFTC and

the SEC. Yet, the Court of Appeals' decision has this effect. Thus, it is up to this Court to re-examine this issue and to determine if the Court of Appeals overreached in defining the CFTC's jurisdiction so broadly.

Conclusion

For the reasons stated above, the Petition for a Writ of Certiorari should be granted.

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Petitioners,

v.

CHICAGO MERCANTILE EXCHANGE, BOARD OF TRADE OF THE CITY OF CHICAGO, INVESTMENT COMPANY INSTITUTE, AND SECURITIES AND EXCHANGE COMMISSION,

Respondents.

BRIEF IN OPPOSITION OF RESPONDENTS CHICAGO MERCANTILE EXCHANGE AND BOARD OF TRADE OF THE CITY OF CHICAGO

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QUESTION PRESENTED

Did the Court of Appeals correctly hold that the instruments known as Index Participations are stock index futures contracts and therefore subject to the exclusive regulatory jurisdiction of the Commodity Futures Trading Commission under the Commodity Exchange Act?

LIST OF PARTIES

The parties in the Court of Appeals were:

The Chicago Mercantile Exchange
The Board of Trade of the City of Chicago
The Philadelphia Stock Exchange, Inc.
The American Stock Exchange, Inc.
The Options Clearing Corporation
The Chicago Board Options Exchange
The Investment Company Institute
The Securities and Exchange Commission
The Commodity Futures Trading Commission
(as *amicus curiae*)

Pursuant to this Court's Rule 29.1, respondents Chicago Mercantile Exchange and Board of Trade of the City of Chicago state that they are membership corporations and are wholly owned by their members. They have no parent corporations and no subsidiaries which are not wholly owned by them.

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Nos. 89-1502, 89-1503

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

AMERICAN STOCK EXCHANGE, INC., CHICAGO BOARD OPTIONS EXCHANGE, INCORPORATED, THE OPTIONS CLEARING CORPORATION, AND PHILADELPHIA STOCK EXCHANGE, INC.,

Petitioners,

v.

CHICAGO MERCANTILE EXCHANGE, BOARD OF TRADE OF THE CITY OF CHICAGO, INVESTMENT COMPANY INSTITUTE, AND SECURITIES AND EXCHANGE COMMISSION,

Respondents.

BRIEF IN OPPOSITION OF RESPONDENTS CHICAGO MERCANTILE EXCHANGE AND BOARD OF TRADE OF THE CITY OF CHICAGO

Respondents Chicago Mercantile Exchange ("CME") and the Board of Trade of the City of Chicago ("Board of Trade") oppose the certiorari petitions filed by the American Stock Exchange, Inc. ("AMEX"), Chicago Board Options Exchange ("CBOE"), and The Options Clearing Corporation ("OCC") in No. 89-1502 and the Philadelphia Stock Exchange, Inc. ("PHLX") in No. 89-1503. The CME and Board of Trade file this consolidated brief in opposition.

The petitions provide no adequate reason for this Court to grant certiorari and should be denied because:

1. The Seventh Circuit's decision is correct. Index Participations ("IP's") are stock index futures contracts subject to the exclusive regulatory jurisdiction of the Commodity Futures Trading Commission ("CFTC") under the Commodity Exchange Act. As such, the CFTC's jurisdiction over IP's supersedes any authority the Securities and Exchange Commission ("SEC") might otherwise have had.

2. Petitioners grossly exaggerate the consequences of the Seventh Circuit decision. The decision neither blurs the distinctions between securities and futures contracts nor stifles innovation in the financial markets.

3. The policy issue raised by the petitions—whether the CFTC should continue to have exclusive jurisdiction over stock index futures—is currently under active review by Congress. Congress chose to give the CFTC this exclusive jurisdiction and Congress alone should decide whether to adjust this jurisdictional assignment.

RELEVANT STATUTES

Pursuant to Section 2(a)(1)(A) and (B) of the Commodity Exchange Act, 7 U.S.C. §§ 2, 2a (Joint Appendix of Petitioners ("App.") 112-119), the CFTC has exclusive jurisdiction over all futures contracts, including specifically stock index futures.

Under Section 9(g) of the Securities Exchange Act of 1934, 15 U.S.C. § 78i(g) (App. 120), the SEC has exclusive jurisdiction over stock index options.

The definition of "security" is found in Section 3(a)(10) of the Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(10) (App. 119-120).

STATEMENT OF THE CASE

Proceedings Below

During 1988, PHLX, AMEX, and the CBOE filed with the SEC proposed rule changes seeking SEC approval to trade IP's. During each of the public comment periods on the proposed rule changes, the CFTC advised the SEC that the CFTC had determined that IP's were stock index futures within the CFTC's exclusive jurisdiction and that the SEC lacked authority to regulate IP's. The CME and Board of Trade filed similar objections.

The SEC's Decision

Notwithstanding the CFTC's view, the SEC concluded that it had jurisdiction over IP's primarily because the SEC found that IP's sufficiently resembled stock to constitute "stock" within the definition of "security" in Section 3(a)(10) of the Securities Exchange Act, 15 U.S.C. § 78c(a)(10), App. 49-52. In addition, the SEC deemed an IP to be a "security" under other components of the statutory definition of that term. *Id.* at 50, 52. Although urged to do so by AMEX, the SEC did not adopt the view that IP's were stock index options, a type of security over which Congress had vested exclusive jurisdiction in the SEC. *Id.* at 52 n. 57.

Giving no weight or deference to the CFTC's determination, the SEC also ruled that IP's were not stock index futures contracts. Instead of relying upon the CFTC's construction of its enabling statute, the SEC issued its own different construction of the Commodity Exchange Act and ruled that IP's lack the "futurity" and "bilateralism"

that the SEC decided were requisites of futures contracts. App. 53-63.

The Court of Appeals Decision

The CME and Board of Trade petitioned for review to the Seventh Circuit, where the CFTC appeared as *amicus curiae*. The Seventh Circuit unanimously set aside the SEC's order because the SEC lacked jurisdiction over IP's. Having analyzed both the SEC's and CFTC's interpretations of the relevant statutes as applied to IP's, the Court of Appeals held that the CFTC had exclusive jurisdiction over IP's.

Initially, the Court of Appeals disposed of the SEC's claim that IP's were akin to "stock." App. 14-15. The Court of Appeals emphasized:

> IPs are not stock *in* anything. . . . Stock is an equity interest in an issuer, the residual claim to the profits of a venture. . . . Purchasers of IPs don't own equity, directly or indirectly. . . . *Id.*; emphasis in original.

Moreover, the Seventh Circuit observed that, although IP's "do not fit comfortably into the other pigeonholes of [the definition of security in] § 3(a)(10)," there was a "basis for drawing IPs within § 3(a)(10), even though they do not duplicate a recognized category." *Id.* at 15.

The Court of Appeals next analyzed whether IP's were futures contracts, as the CFTC maintained. First, the Seventh Circuit dismissed the SEC's claim that IP's lacked the "futurity" of futures contracts.

> [T]he SEC is wrong. IPs are no more a "present obligation to pay current value" than are futures contracts. The holder of either an IP or

> a stock-index futures contract may go to market and trade it; the price necessarily tracks current value. App. 16.

The Court of Appeals considered IP's and futures from the perspectives of the buyers (longs) and sellers (shorts). The Court of Appeals found that "from the long's point of view, IP and futures contract ultimately look the same" (*id.* at 17), while "[s]horts on IPs make the same pledge as shorts on stock index futures contracts. . ." (*id.* at 16). Upon completing this analysis, the Court of Appeals noted the conflicting agency interpretations and reasoned:

> If each agency's interpretation of its own statute is entitled to some deference, then the IP is both a security and a futures contract. It has some attributes of both, and all attributes of neither, as we have laid out in excessive detail. Neither characterization can be called wrong. *Id.* at 20.

The Court of Appeals then applied the exclusive jurisdiction provision in Section 2(a)(1)(B)(ii) of the Commodity Exchange Act, 7 U.S.C. 2a(ii), and held that the SEC had no jurisdiction to approve or regulate IP's:

> An instrument either is or is not a futures contract. If it is, the CFTC has jurisdiction; if it is not, the CFTC lacks jurisdiction; if the CFTC has jurisdiction, its power is exclusive. *Id.* at 21.

The Court also explained that if IP's were stock index options, the SEC's authority over those instruments could have trumped the CFTC's exclusive jurisdiction. *Id.* at 14. Like the SEC and CFTC, the Court of Appeals did not find IP's to be options. *Id.* at 17-18. Thus, the Court

of Appeals set aside the SEC's order approving IP's for trading on the securities exchanges.

Stock Index Futures Contracts

Stock index futures contracts extend the traditional futures contract functions—hedging and speculating—to an index of prices of publicly traded stocks. Stock index futures have the following basic characteristics:

1. The purchaser (long) and seller (short) enter into a contract based on the value of a stock index at a specified future date (the settlement or delivery date).
2. Neither the long nor the short owns the stock comprising the index.
3. The long or short may close out or cancel the stock index futures position on any trading day by an "offsetting" or "opposite" transaction with any other trader. The long would sell a sufficient number of futures to cover the contracts previously purchased, and conversely the short would purchase the same number of contracts previously sold.
4. Through these offsetting transactions, the long will profit from a rise in the index value compared to the initial contract price, and conversely the short will profit from a fall in the index value.
5. If the futures contract is not offset by the settlement or delivery date, the long or short will pay or receive the cash difference between the initial purchase price of the contract and the value of the contract on the last day of trading. (Physical delivery of the stocks in the index

> is prohibited under 7 U.S.C. § 2a(ii)(I).) Again, a long profits from an increase in the index value; a short profits from a decline in index value.[1]

Thus, as this Court noted in *Merrill Lynch, Pierce Fenner & Smith v. Curran*, 456 U.S. 353, 358 (1982), "[t]he purchase or sale of a futures contract on an exchange is . . . motivated by a single factor—the opportunity to make a profit (or to minimize the risk of loss) from a change in the market price."

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[1] *See* the discussion of stock index futures in Katzenbach, An Overview of Program Trading and Its Impact on Current Market Practices 6-9 (1987) ("Katzenbach Study"); Board of Governors of the Federal Reserve System, CFTC, and SEC, A Study of the Effects on the Economy of Trading in Futures and Options, Chap. II, pp. 1-33 (1984). The Katzenbach Study (pp. 7-8) gave examples of how stock index futures operate:

> The use of index futures is relatively simple. For example, the popular S&P 500 index future is a contract to buy or sell the value of the S&P 500 Index multiplied by $500. Thus, if the value of the S&P 500 Index were 245, one contract would be worth $122,500 (value of the index [245] multiplied by $500). The index futures contract specifies that settlement in cash must occur upon the termination of the contract, with the settlement being the difference between the contract price and the actual level of the stock index at the expiration of the contract. Thus, if an investor entered into a futures contract to buy a contract of the S&P 500 Index at a specified future date at 245, and the S&P 500 Index is 249 on that future date, the investor would gain $2,000 ($500 multiplied by the gain of 4). If the investor entered into a futures contract to sell an S&P 500 futures contract at the contract price of 245 and the S&P 500 Index is at 249 on that future date, the investor would lose $2,000 ($500 multiplied by a loss of 4).

Stock Index Participation Contracts

IP's have the following basic characteristics:

1. The purchaser (long) and seller (short) enter into a contract based on the value of a stock index at a specified future date (the cash-out date).
2. Neither the long nor the short owns the stocks comprising the index.
3. The long or short may close out or cancel their IP positions on any trading day by an "offsetting" or "opposite" transaction with any other trader. The long would sell a sufficient number of IP's to cover the contracts previously purchased, and conversely the short would purchase the same number of contracts previously sold.
4. Through these offsetting transactions, the long will profit from a rise in the index value compared to the initial contract price, and conversely the short will profit from a fall in the index value.
5. If the IP is not offset by the cash-out date and the long decides to end the agreement on the cash-out date, the long or short will pay or receive the cash difference between the initial purchase price of the IP and the value of the IP on the cash-out date. Again, a long profits from an increase in the index value; a short profits from a decline in the index value. If offset or cash-out does not occur by the end of each calendar quarter, then the IP long is credited and the IP short is debited for dividend equivalency payments resembling the dividends the IP long would have re-

> ceived had he owned the stock. This payment, of course, is reflected in the IP's market price.[2]

As with stock index futures, the purchase or sale of an IP is motivated by a single factor—to make a profit or minimize the risk of loss from a change in the market price.

REASONS FOR DENYING THE WRIT

I. THE SEVENTH CIRCUIT'S DECISION IS CORRECT.

The Court below correctly decided (1) that IP's are futures contracts under the CFTC's exclusive jurisdiction, and (2) that IP's are not stock index options within the SEC's jurisdiction.

A. IP's Are Futures Contracts.

In 1982, the SEC and CFTC agreed that the CFTC should have exclusive regulatory jurisdiction over stock index futures. To that end, the agencies jointly proposed, and Congress enacted, legislation which provides that:

> Notwithstanding any other provision of law— . . .
>
> (ii) This chapter shall apply to and the [CFTC] shall have exclusive jurisdiction with respect to . . . transactions involving, and may designate a board of trade as a contract market in, *contracts*

[2] Each of the petitioning exchanges added features to its own IP without changing the common economic essence. PHLX would permit cash-out at the end of each quarter without penalty and cash-out at 99.5% of the next day's closing index value at any other time. CBOE would allow semiannual cash-out by either the long or the short. AMEX would permit only quarterly cash-out but would provide the alternative of actual delivery of the underlying stock to settle the IP's, under restrictive conditions.

> *of sale . . . for future delivery of a group or index of securities (or any interest therein or based upon the value thereof). . . .* 7 U.S.C. § 2a, App. 116-117; emphasis added.

Thus, if IP's are stock index futures contracts, or contracts of sale for future delivery of the value of an index of securities, the SEC had no jurisdiction to approve IP's.

As the Court of Appeals ruled, IP's are futures contracts. Like other stock index futures, IP's are instruments that allow the parties to speculate on the future value of a group of stocks, without owning the stocks. App. 14-17. In assessing the common economic substance of futures and IP's, the Court of Appeals found:

> Shorts on IPs make the same pledge as shorts on stock-index futures contracts: to pay the value of an index on a prescribed day (the expiration date for the futures contract, the cash-out date for the IP). . . . Even from the long's point of view, IP and futures contracts ultimately look the same. The long pays up front for the IP, but the long on a futures contract *promises* up front to make a defined payment on the settlement date; the difference in the timing of the payment does not affect the fact that valuation comes at the defined future date. *Id.* at 16-17; emphasis in original.

The economic reality of IP's thus compelled the Court of Appeals to find IP's to be stock index futures.

The Court of Appeals focused on the economic substance of IP's in keeping with the interpretive principles set down by this Court in deciding what is a security. Under these principles, "we are not bound by legal formalisms, but instead take account of the economics of the transaction under investigation." *Reves v. Ernst & Young*, ___ U.S. ___, 110 S.Ct. 945, 949 (Feb. 21, 1990). The Court

of Appeals reasoned that "[i]f the interpretive approach is proper for the securities acts, it is no less proper for the futures acts." App. 23. Under these principles, the Court of Appeals disregarded form for substance in finding IP's to be futures and correctly rejected the SEC's formalistic approach to defining futures—an approach that would have created a serious regulatory gap under the Act. *Id.* at 24.

Unable to refute the Court of Appeals' conclusion that IP's are futures, petitioners first try to recast IP's and then misconstrue the Court of Appeals' decision. Contrary to petitioners' descriptions, IP's are not "market baskets of common stock" (AMEX Pet. at 13) or a "market basket security" (PHLX Pet. at 3). To reiterate what the Court of Appeals emphasized, "IP's are not stock *in* anything." App. 14; emphasis in original. IP purchasers do not own a market basket of stocks; indeed, as the Court of Appeals noted, unlike stocks "IP's don't carry votes because they don't have anything to do with equity." *Id.* at 15.

Petitioners also contend that under the Court of Appeals' holding any financial instrument for which value is "realized" (PHLX Pet. at 7) or "received" (AMEX Pet. at 20) at a future date has "futurity" and is therefore a futures contract. Based on this contention, petitioners argue that the decision below creates uncertainty over whether traditional securities including stocks and bonds as well as new types of securities are subject to SEC or CFTC jurisdiction. This uncertainty does not exist.

The Court of Appeals found an IP to be a futures contract because (1) an IP's value depended upon the ongoing market assessment of the value that the stock index would have on a "prescribed" or "defined" future date (App. 16-17) and (2) IP's do not convey an ownership interest in the stock in the index. *Id.* at 14-15. Far from the novel

pronouncement petitioners claim, the Court of Appeals' decision merely adopts the concept of futurity and the definition of a futures contract set forth in the only other appellate case addressing these issues, *CFTC v. Co Petro Marketing Group, Inc.*, 680 F. 2d 573 (9th Cir. 1982). Under this ruling, as the Court of Appeals explained, an instrument is a futures contract if its "value depended entirely on the price of the commodity at [its] expiration date, and [it was] not formed in contemplation of physical delivery." App. 21.

The focus of the Courts of Appeals on ownership or physical delivery in determining whether an instrument is a futures contract is grounded in the statute. Congress mandated under the Commodity Exchange Act that "future delivery" does "not include any sale of any cash commodity for deferred shipment or delivery." 7 U.S.C. § 2, App. 113. Under the law as applied by the Court of Appeals, therefore, the actual sale of a stock or bond cannot be for future delivery, notwithstanding petitioners' hyperbole to the contrary (PHLX Pet. at 8; AMEX Pet. at 20).

Application of the Court of Appeals' true principles to the parade of horribles portrayed by petitioners turns that parade into an apparition. Purchasers of stocks or bonds own the underlying securities; purchasers of stock index futures and IP's do not. Stock and bond purchasers also hope their investments will appreciate in value by an unspecified date in the future; longs and shorts in stock index futures or IP's are speculating that the value of a stock index will increase (or decrease) by a specified future date. Accordingly, under the Court of Appeals' decision, *when* a purchaser or seller of a futures contract receives value is meaningless. What counts is whether the instrument is structured to provide the market participants with an opportunity to speculate on or hedge

against price changes based upon the market's ongoing assessment of the instrument's value tied to a specified future date.[3]

In sum, petitioners fail to recognize the fundamental difference between changes in an asset's value over time and the "futurity" of a futures contract that ties the instrument's valuation to a specified future date. Therefore, petitioners' concern that the Court of Appeals has created a broad new definition of "futurity" is completely unfounded.

Petitioners also complain that IP's are not strictly "bilateral." (PHLX Pet. at 10-11; AMEX Pet. at 19.) The Court of Appeals correctly dismissed this contention (App. 21) because "bilateralism is not essential to a futures contract," citing *CFTC v. Co Petro Marketing Group, Inc., supra.*

The asserted missing bilateralism stems from certain superficial payment differences in IP's and stock index futures. Upon entering into an IP, the long pays for the IP in full or pays in full a margin deposit equal to 50% of the IP's then current value. App. 81. Upon entering into a stock index futures contract, the long pays in full

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[3] This distinction between ongoing *valuation* tied to a future date and delayed *receipt* of value explains why PHLX's next-day cash-out alternative does not deprive IP's of futurity. PHLX allows an IP long to decide on one day to receive 99.5% of the IP's *next-day's* closing index value. Thus, when the long buys the IP and when he decides to cash out, he still cannot know what the IP's cash-out value will be.

Moreover, an IP's dividend equivalency payment does not distinguish an IP from a future. The value of the credit to the long or debit to the short for this pseudo-dividend is factored into the overall market value of an IP. Similarly, actual dividends declared and paid on the stocks in a stock index are taken into account by those trading the futures contract on that index.

the required margin deposit of approximately 10-15% of the then current value of the futures contract. As the Court of Appeals notes, this formalistic difference is meaningless because it "does not affect the fact that valuation comes at the defined future date." App. 17.

In other words, if an index futures long paid margin reflecting 50% or 100% of the then current value of the index, that would not transform the futures contract into a security.[4] The futures contract would remain a futures contract, regardless of the size of the margin payment, unless the long acquired the stock in the index upon entering into the contract and the contract's value was not tied to a defined future date. IP's do not have these characteristics. Thus, the Court of Appeals correctly found IP's to be futures.

B. IP's Are Not Options or Privileges.

AMEX (but not PHLX) has contended throughout that IP's are stock index options within the SEC's jurisdiction under 15 U.S.C. § 78i(g), App. 120. Options, however, have a settled business and legal definition: the buyer pays a "premium" to acquire the right, but not obligation, to buy the stock from the seller at the "strike" or "exercise" price. The instrument is termed an "option" because the buyer has the alternative not to consummate the purchase of the underlying stock if its market price falls below the "strike" price. An option is thus a limited risk investment because only the premium is lost if the option is not exercised. *See Deutschman v. Beneficial Corp.*, 841 F.2d 502, 504 (3d Cir. 1988), *cert. denied*, ____ U.S. ____, 109 S.

[4] Recently, the Commodity Exchange, Inc. called for 100% margin for its April copper futures contract. "Comex moves to avert squeeze on copper futures," *Financial Times*, p. 30, April 25, 1990. No one would seriously argue that 100% margin caused the copper futures contract to become a security.

Ct. 3176 (1989); *Laventhall v. Gen'l Dynamics Corp.*, 704 F.2d 407, 410-411 (8th Cir.), *cert. denied*, 464 U.S. 846 (1983). AMEX attempted to force IP's into the option definition by labeling the *full* purchase price paid by the long as the "premium," thus making the "strike" or "exercise" price *zero*, and by arguing that the long had the "option" *never* to exercise it, thereby forfeiting the entire amount paid up front. However, the SEC did not find that IP's are options, App. 52 n. 57, and the Court of Appeals emphatically rejected the contention, *id.* at 18.

AMEX, the CBOE, and CCC (but again not PHLX) attempt to recycle the rejected "option" argument by using the word "privilege" instead, one of several option synonyms ("put," "call," and "straddle" are the others) appearing in both the futures and securities statutes. Petitioners contend that use by Congress of several different "option" terms "suggests" that each has different attributes. (AMEX Pet. at 23.) In fact, "privilege" traditionally has been used merely as a generic synonym for "option." *See, e.g., Trusler v. Crooks*, 269 U.S. 475, 481 (1926).[5] Petitioners, indeed, make no showing that "privilege" means anything other than "option." Petitioners offer no case law, legislative history, or legal scholarship finding in the term "privilege" the broad meaning they would have this Court give it.

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[5] *See also* 80 CONG. REC. 8089 (1936) (remarks of Sen. Pope):

> Privileges, indemnities, bids, offers, puts, calls, etc.: These are true option contracts wherein, for a relatively small money consideration, the buyer of a privilege or indemnity obtains the right, during the next day (in the case of daily privileges) or during the next week (in the case of weekly privileges) to buy or sell, as the case may be, a stated amount of a given commodity for future delivery at a then stipulated price. A privilege contract giving the buyer the right to sell is called a "bid" or a "put," and the right given to buy is called an "offer" or a "call."

Moreover, petitioners' argument would sweep too broadly. If IP's are index "privileges," then stock index futures would also be "privileges" under SEC jurisdiction. Since the SEC and the CFTC jointly urged Congress to provide the CFTC exclusive jurisdiction over stock index futures, "privilege" cannot have the undefined breadth that petitioners imagine.

II. THE DECISION BELOW WILL NOT STIFLE INNOVATION.

Petitioners inaccurately claim that the Court of Appeals' decision is significant as a policy matter because it will stifle innovation in the securities markets. In the first place, IP's are not truly innovative. As demonstrated above, an IP is just a stock index futures contract wrapped in a different label. Moreover, the Court of Appeals' decision does not prevent IP's from being traded in the United States.[6] If PHLX and AMEX proposed to trade IP's on their affiliated futures exchanges and subject to CFTC jurisdiction, the CFTC has indicated publicly that it sees no impediment to expedited approval of IP's trading under the Commodity Exchange Act. 136 CONG. REC. S1991 (daily ed. March 1, 1990) (reprinted speech by CFTC Chairman Wendy L. Gramm).

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[6] The IP's traded on the Toronto Stock Exchange, to which AMEX refers (AMEX Pet. at 15 n. 18), bear no resemblance to the IP's involved in this case. The Toronto IP's ("TIP's") are based on the Toronto 35 Index and constitute actual ownership units of a trust which in turn owns the stocks underlying the index. Actual dividends paid on the underlying stocks are accumulated by the trust and paid quarterly to the TIP owners. Owners of a sufficient volume of TIP's may redeem them for the underlying stocks at any time. *Investor's Daily*, March 19, 1990, at p. 11. These features were specifically introduced to distinguish TIP's from petitioners' IP's and ensure that TIP's are equity products and not futures. *Wall Street Letter*, August 7, 1989, at p. 8.

In the many months since the Court of Appeals' decision, PHLX and AMEX have not sought CFTC approval. Their failure to pursue IP's trading is explained by AMEX in two ways. First, since there is a larger group of registered securities salesmen than futures salesmen, the securities exchanges refuse to apply for CFTC approval of IP's. AMEX Pet. at 14. The size of the sales force, however, is not a principled basis for assigning regulatory jurisdiction. In any event, the CFTC has said it will consider cross-registering the securities salesmen under the Commodity Exchange Act for the purpose of trading IP's as futures. *See* 136 CONG. REC. at S1991. Second, many investors cannot by law or contract trade futures so IP's should not be considered futures. AMEX Pet. at 14. Disguising a futures contract as an IP in order to slip it by otherwise applicable legal restrictions is unsound policy at best, and no reason to narrow the definition of a futures contract.

The Court of Appeals properly refused to adopt these arguments:

> An instrument either is or is not a futures contract. If it is, the CFTC has jurisdiction; if it is not, the CFTC lacks jurisdiction; if the CFTC has jurisdiction, its power is exclusive. App. 21.

Similarly, the Court of Appeals refused:

> . . . to put a thumb on the scales, enlarging the category "securities" while shrinking the category "futures" because of the exclusivity clauses in the CEA: if both categories expand, then the SEC's jurisdiction shrinks. We do not conceive it our function, however, to invent counterweights to statutes; judges should be interpreters rather than sappers and miners. *Id.* at 24.

Finally, petitioners' concern that the Court of Appeals' decision is the death knell of new securities instruments

is belied by the New York Stock Exchange's new Exchange Stock Portfolio ("ESP"). The ESP is a true market basket since purchasers of the ESP own the stocks in the ESP basket.[7] Neither the CFTC nor respondents objected to the ESP because it is not a futures contract under the well-settled principles adopted by the Court of Appeals. Thus, the Seventh Circuit's decision has not stymied innovative securities instruments at all.[8]

III. CONGRESS IS CURRENTLY ADDRESSING THE JURISDICTIONAL ISSUE RAISED IN THIS CASE.

From the very creation of the CFTC, the securities industry has been fighting against CFTC control of futures contracts on financial instruments. Congress enacted the CFTC Act in 1974 and established broad CFTC jurisdiction over futures. The legislative history of the Act demonstrates that the CFTC was created "to fill all regulatory gaps—to regulate trading in futures and in options relating to commodities or commodity futures, because such trading is now poorly regulated if it is regulated at all." 120 CONG. REC. 34736 (1974) (Rep. Poage, Chairman of the House Agriculture Committee). Yet, in late 1974, when "the ink was barely dry" on the CFTC Act, the SEC proposed legislation that would have removed the CFTC's exclusive jurisdiction over futures, but Congress

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[7] *See* "NYSE Sets S&P 500 Product," *Chicago Tribune*, June 2, 1989, Sec. 3, p. 5.

[8] Moreover, as one commentator has recently noted, "handing futures regulation over to the SEC is no guarantee of innovation. The CFTC-regulated exchanges have been far more creative than the financial institutions regulated by the SEC." *Business Week*, April 16, 1990, at p. 100.

took no action. 2 Johnson & Hazen, Commodities Regulation § 437 (2d ed. 1989) at 267. In 1978 the SEC asked Congress to transfer all jurisdiction over financial futures from the CFTC to the SEC, but Congress again refused because it wanted to preserve the "economic expertise" of the CFTC over futures trading and avoid duplication of regulation over futures markets. *Id.* at 267-268; *see also* H.R. Rep. No. 1181, 95th Cong., 2d Sess. 13 (1978) (House Agr. Comm.); S. Rep. No. 95-850, 95th Cong. 2d Sess. 22-23 (1978) (Sen. Agr. Comm.).

This running dispute resulted in earlier jurisdictional litigation similar to this case. *See Chicago Board of Trade v. SEC*, 677 F. 2d 1137 (7th Cir.), *vacated as moot*, 459 U.S. 1026 (1982). That case became moot with the enactment by Congress of the Johnson-Shad Accord legislation which preserved CFTC exclusive jurisdiction over financial futures and, specifically, stock index futures.

Congress now is considering a number of proposals to address the CFTC-SEC jurisdictional issues.[9] Congress gave the CFTC exclusive jurisdiction in order to oust the SEC from regulating stock index futures, like IP's. If Congress decides that policy decision was sound, Congress will not revise the statute. If Congress decides that policy decision was unsound, Congress can revise the statute as it has done in the past. This Court need not and should not.

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[9] *See, e.g.*, 136 CONG. REC. E988-989 (daily ed. April 4, 1990) (remarks of Rep. Eckart); 136 CONG. REC. E983-985 (daily ed. April 4, 1990) (remarks of Rep. Glickman); 136 CONG. REC. S3205-3206 (daily ed. March 26, 1990) (remarks of Sen. Dixon); and 135 CONG. REC. S15379 (daily ed. November 9, 1989) (remarks of Sen. Gorton).

CONCLUSION

For the above reasons, the CME and Board of Trade ask the Court to deny the petitions.

Respectfully submitted,

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Nos. 89-1502, 89-1503 and 89-1484 (4) (3) (3)

In the Supreme Court of the United States

OCTOBER TERM, 1989

AMERICAN STOCK EXCHANGE, INC., ET AL., PETITIONERS

v.

CHICAGO MERCANTILE EXCHANGE, ET AL.

PHILADELPHIA STOCK EXCHANGE, INC., PETITIONER

v.

CHICAGO MERCANTILE EXCHANGE, ET AL.

INVESTMENT COMPANY INSTITUTE, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether financial instruments known as "index participations" are subject to the jurisdiction of the Securities and Exchange Commission, or, alternatively, are subject to the exclusive jurisdiction of the Commodity Futures Trading Commission as "involving contracts of sale of a commodity for future delivery" (7 U.S.C. 2).

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In the Supreme Court of the United States

OCTOBER TERM, 1989

No. 89-1502

AMERICAN STOCK EXCHANGE, INC., ET AL., PETITIONERS

v.

CHICAGO MERCANTILE EXCHANGE, ET AL.

No. 89-1503

PHILADELPHIA STOCK EXCHANGE, INC., PETITIONER

v.

CHICAGO MERCANTILE EXCHANGE, ET AL.

No. 89-1484

INVESTMENT COMPANY INSTITUTE, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-25)[1] is reported at 883 F.2d 537. An opinion denying the

[1] "Pet. App." refers to the appendix jointly filed by the petitioners in Nos. 89-1502 and 89-1503.

petitions for rehearing (Pet. App. 108-111) is reported at 883 F.2d 550. The orders of the Securities and Exchange Commission (Pet. App. 26-83, 84-107) are published at 54 Fed. Reg. 15,280 and 54 Fed. Reg. 15,575, respectively.

JURISDICTION

The judgment of the court of appeals was entered on August 18, 1989. The petitions for rehearing were denied on October 23, 1989. On January 12, 1990, Justice Stevens signed an order extending the time within which to file a petition for a writ of certiorari for the petitioners in No. 89-1502 to and including March 22, 1990, and the petition was filed on that date. On January 17, 1990, Justice Stevens signed an order extending the time within which to file a petition for a writ of certiorari for the petitioner in No. 89-1503 to and including March 26, 1990, and the petition was filed on that date. On January 19, 1990, Justice Stevens signed an order extending the time within which to file a petition for a writ of certiorari for the petitioner in No. 89-1484 to and including March 22, 1990, and the petition was filed on that date. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

This case involves the interpretation of the statutes governing the jurisdiction of the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC). Specifically, the question presented is which agency enjoys regulatory jurisdiction over recently invented financial products known as "index participations".

1. a. The SEC is, of course, charged with responsibility for regulating transactions in securities under the federal securities laws.[2] In the securities laws, Congress "enacted a definition of 'security' sufficiently broad to encompass virtually any instrument that might be sold as an invest-

[2] *E.g.*, the Securities Act of 1933, 15 U.S.C. 77a *et seq.*, and the Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. 78a *et seq.*

ment." *Reves* v. *Ernst & Young*, 110 S. Ct. 945, 949 (1990). A security is defined to include, *inter alia*, "any * * * stock, * * * any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), * * * or in general, any instrument commonly known as a 'security'; or any certificate of interest or participation in * * * any of the foregoing [.]" 15 U.S.C. 78c(a)(10).

The CFTC was created in 1974 as an independent federal agency vested with the exclusive authority to regulate trading in futures contracts, a function that had long been carried out by the Department of Agriculture. Commodity Futures Trading Act of 1974, Pub. L. No. 93-463, 88 Stat. 1389. Congress's purpose in amending the Commodity Exchange Act (CEA) to create the CFTC was to establish a "comprehensive regulatory structure to oversee the volatile and esoteric futures trading complex." H.R. Rep. No. 975, 93d Cong., 2d Sess. 1 (1974); *CFTC* v. *Schor*, 478 U.S. 833, 836 (1986). Under the CEA, the CFTC has "exclusive jurisdiction * * * with respect to * * * transactions involving contracts of sale of a commodity for future delivery." 7 U.S.C. 2.

b. In 1981, a disagreement arose between the CFTC and SEC over which agency had authority to regulate trading in a particular financial product. The SEC had approved trading on a securities exchange of standardized options on mortgage-backed debt securities guaranteed by the Government National Mortgage Association (GNMA). In a challenge brought by the Chicago Board of Trade, the Seventh Circuit set aside the SEC's orders on the ground that GNMA options involved futures contracts, the regulation of which was entrusted to the CFTC. See *Board of Trade* v. *SEC*, 677 F.2d 1137 (1982), vacated as moot, 459 U.S. 1026 (1982).[3]

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[3] The Solicitor General filed a petition for a writ of certiorari on the SEC's behalf in that case. *SEC* v. *Board of Trade of the City of Chicago, et al.*, No. 82-526. The enactment of legislation superseding the court of appeals' ruling rendered the case moot,

While the litigation was pending, the CFTC and SEC reached an agreement, known as the Shad-Johnson Accord, on how to divide their respective jurisdictions with respect to options on securities and certain other securities-derivative products. Congress subsequently enacted legislation that, in essence, implemented the agencies' agreement.[4] The legislation "clarified" that the SEC would regulate "options on all securities, and securities groups and indices," H.R. Rep. No. 626, 97th Cong., 2d Sess. Pt. 1, at 10-11 (1982), while the CFTC would regulate "futures contracts on broad based groups or indices of any securities as well as options on any such futures contracts." H.R. Rep. No. 626, *supra*, Pt. 2, at 2. See also S. Rep. No. 384, 97th Cong., 2d Sess. 21-24 (1982); H.R. Rep. No. 565, 97th Cong., 2d Sess. Pt. 1, at 38-40 (1982).[5]

2. In the late winter and spring of 1988, several stock exchanges sought the SEC's approval to list index participations for trading. In accordance with 15 U.S.C. 78s(b), the SEC published notice of the proposals in the Federal Register.

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and, accordingly, this Court vacated the judgment. 459 U.S. 1026 (1982).

[4] See Act of Oct. 13, 1982, Pub. L. No. 97-303, 96 Stat. 1409 (amending the federal securities laws); Act of Jan. 11, 1983, Pub. L. No. 97-444, 96 Stat. 2294 (amending the Commodity Exchange Act).

[5] Pursuant to the Accord, the SEC was granted jurisdiction to regulate "the trading of any put, call, straddle, option, or privilege on any security * * * or group or index of securities (including any interest therein or based on the value thereof)," 15 U.S.C. 78i(g), while such jurisdiction was withheld from the CFTC. 7 U.S.C. 2a(i). The CFTC, in turn, was given "exclusive jurisdiction with respect to * * * transactions involving * * * contracts of sale * * * for future delivery of a group or index of securities (or any interest therein or based on the value thereof) [.]" 7 U.S.C. 2a(ii). Congress also conferred authority upon the SEC to disapprove applications to trade futures contracts based on the value of a group or index of securities (or options on such contracts) if the SEC determined that the statutory requirements for such contracts (or options) were not satisfied in a particular case. 7 U.S.C. 2a(iv)(II).

Index Participations (IPs) are standardized contracts based on the value of an index representing a portfolio of securities.[6] IPs do not represent ownership interests in an actual "market basket" of securities; rather, they provide vehicles for traders to experience gains or losses based on the performance of the underlying stock index (for example, the Standard & Poor's 500). The purchaser of an IP (the "long" or "holder") will profit from increases in the value of the index. The seller of an IP (the "short") will profit from a downturn in the index. With one exception, IPs do not involve any actual securities changing hands.[7] In addition, the shorts and longs do not deal directly with each other; after an IP contract is formed on an exchange, IPs are issued, cleared, and settled by a clearing corporation (here, the Options Clearing Corporation). IPs have no fixed expiration date; their existence is therefore—at least potentially—perpetual.

An IP holder acquires a contract by paying a market price that approximates the value of the index on the date of purchase, times a multiplier. The IP holder has two principal rights. First, the IP holder is entitled to "dividend-equivalent" payments approximating the cumulative dividends that would have accrued to a person owning a weighted basket of the securities in the index. Second, the IP holder may exercise the right to be paid the value of the index on a designated "cash out" date.[8]

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[6] The following description of IPs is based on the SEC's orders (Pet. App. 27-24, 84-98), and a disclosure document prepared under the auspices of the Options Clearing Corporation (OCC) to describe IPs to potential traders (C.A. App. 545-559).

[7] The American Stock Exchange, Inc. (Amex) IP gave the holder the right to take delivery of the index stocks under certain circumstances. See Pet. App. 28-29.

[8] The particular dates varied among the stock exchanges. The Philadelphia Stock Exchange, Inc. (Phlx) IP provided a 100% cash-out privilege quarterly and a cash-out privilege at all other times for 99.5% of the value of the index. The Amex IP provided a quarterly cash-out privilege. The Chicago Board of Options Exchange, Inc. (CBOE) IP provided a semi-annual cash-out privilege.

An IP short makes the reciprocal promise to pay the value of the index if and when an exercise notice is assigned to him on a cash-out date, and to pay the dividend equivalents. At any time, a long or short IP position can be liquidated, and profits or losses realized, by entering into the opposite type of transaction on the exchange (a "closing" or "offset" transaction).

In response to the SEC's notice regarding IPs, the CFTC and two futures exchanges filed comments urging that IPs were futures, and therefore not subject to SEC jurisdiction. The same comments also urged that IPs were not "securit[ies]" under the federal securities laws. Pet. App. 37-38. The Investment Company Institute (ICI) submitted comments arguing that IPs were governed by the Investment Company Act. *Id.* at 37.

On April 11, 1989, the SEC approved the proposals to trade IPs, concluding that: (a) IPs are "securities," Pet. App. 47-53; (b) IPs are not "futures contracts" within the exclusive jurisdiction of the CFTC, *id.* at 53-66; and (c) IPs are not subject to regulation under the Investment Company Act, *id.* at 66-67. The SEC also found that IPs would provide advantages to retail investors seeking to invest in "the market", and that the trading of IPs might reduce stock market volatility. *Id.* at 68 & n.97.

3. The futures exchanges filed petitions for review in the Seventh Circuit, which set aside the SEC's orders.[9] The court of appeals framed the issue as whether IPs are futures contracts; if so, under the applicable jurisdictional provision, 7 U.S.C. 2, the CFTC's jurisdiction was exclusive, even if the instruments were also securities under the federal securities laws. Pet. App. 14.

The court noted that from the perspective of the holder of an IP, the instrument resembles an interest in a portfolio of stock, except that an IP confers no voting rights. From the perspective of the short, however, the court found that an IP resembles a futures contract because the

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[9] The CFTC filed a brief as amicus curiae, urging that IPs are futures contracts subject to its regulation.

short promises to make future delivery of the value of the underlying index. Pet. App. 14-16. Observing that neither the securities laws nor the CEA addressed such a product in a straightforward way, the court considered whether deference to the agencies' respective interpretations of their statutes was appropriate. Assuming without deciding that both the SEC and the CFTC were entitled to "some deference" in their competing claims to apply their statutes to IPs, the court concluded that "the IP is both a security and a futures contract." *Id.* at 20. The court explained that "[t]he only element of financial futures contracts that is missing is 'bilateralism,'" but that characteristic, the court stated, "is not essential to a futures contract." *Id.* at 21.[10] Applying the requirement in 7 U.S.C. 2 that the CFTC's jurisdiction is exclusive over products that are futures contracts, the court set aside the SEC's orders.[11]

ARGUMENT

The court of appeals held that an IP has attributes of both a security and a futures contract, and it ultimately concluded that under the regulatory schemes governing futures and securities, the CFTC has sole authority to regulate such instruments. Although the question decided by the court of appeals was a narrow one, its proper resolution is important to regulators, to the financial markets subject to their jurisdiction, and to the interpretation of the two statutory schemes in question. In the SEC's view, the court's holding is wrong and its under-

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[10] By the term "bilateralism," the court referred to the characteristic of an instrument that creates future obligations on both sides. The court agreed with the SEC that "IPs are not bilateral because the long performs in full by paying up front[.]" Pet. App. 16.

[11] The court therefore did not reach the ICI's contention that IPs created arrangements subject to the Investment Company Act. Pet. App. 25. The court subsequently filed an opinion denying the stock exchanges and the SEC's petitions for rehearing, in which it rejected additional arguments, *id.* at 108-109; two judges voted to rehear the case en banc. *Id.* at 100-111.

lying analysis creates a climate of uncertainty about the proper boundaries between its jurisdiction and that of the CFTC; this, the SEC strongly believes, will harm financial innovation, capital markets, and investors. The SEC continues to subscribe to the views expressed in its orders and believes that, in light of the importance of the issues presented, review by this Court is warranted. In the opinion of the CFTC, the decision below is correct, does not announce principles that extend the CFTC's jurisdiction to areas entrusted to other regulators, and will not harm the operations of the Nation's financial markets.

While the SEC's views about its statute and the industry it regulates are entitled to weight, we cannot agree with the SEC that the decision below is incorrect, or that the analytical framework it employed departed from the intent of Congress in dividing authority between the SEC and CFTC. In our view, the court of appeals properly applied the CEA in finding that IPs are "contracts of sale of a commodity for future delivery" within the sole regulatory authority of the CFTC. That holding rests on a natural interpretation of the language of the CEA, and it fully accords with Congress's purposes in entrusting the exclusive regulation of futures contracts to a specialized agency. Moreover, we do not believe that the opinion augurs a wholesale expansion of CFTC jurisdiction at the expense of other agencies. The opinion itself suggests limiting principles, and other limiting principles are likely to be developed.

It is possible that the development of some new financial products will be "chilled" (as the SEC believes has already occurred) by the imprecision of the analysis governing whether a product is a futures contract, although hard evidence in support of that proposition is difficult to come by. At bottom, however, such consequences, to the extent they do exist, raise policy questions appropriate for Congress, rather than this Court, to address. While we fully agree that it would be desirable to have clear standards to apply in predicting which agency has jurisdiction to regulate a particular

product, the statutory schemes at issue are not susceptible to such "bright-line" tests. Not only is some imprecision inherent in the language chosen by Congress, the difficulty is compounded by the rapid development of new financial instruments not envisioned when Congress fashioned the securities and futures statutes. Because the court below properly resolved the problem at hand, and did so on the basis of correct legal principles, we believe that review by this Court is not warranted.

A. The central submission of the stock exchanges is that IPs are not properly characterized as futures contracts within the meaning of the CEA. The classification of IPs, as the court of appeals recognized, presents something of a conundrum; it requires applying the concepts expressed in each statute to a novel instrument possessing characteristics of both a security and a futures contract, although it is not a conventional version of either. On balance, however, we believe that the language and purposes of the CEA support the court of appeals' holding that IPs are futures contracts.

1. Futures contracts have traditionally been employed by buyers and sellers of commodities to shift the risks posed by fluctuations in price, and by speculators to assume those risks in the hope of earning a profit. See 7 U.S.C. 5 (setting forth legislative findings); H.R. Rep. No. 975, *supra*, at 33-35; S. Rep. No. 1131, 93d Cong., 2d Sess. 9-14 (1974); *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Curran*, 456 U.S. 353, 357-360 (1982) (describing background and purposes of futures contracts). Congress has long provided for the regulation of futures contracts because of their risk-shifting benefits and because of the danger that excessive speculation or manipulation of the futures markets could undermine their utility. 7 U.S.C. 5.

As a general matter, "the seller of the [futures] contract commits himself to deliver the commodity at a fixed date in the future, while the buyer commits himself then to accept delivery and pay the agreed upon price." *Leist* v. *Simplot*, 638 F.2d 283, 286 (2d Cir. 1980) (Friendly, J.), aff'd *sub nom. Merrill Lynch, Pierce, Fenner &*

Smith, Inc. v. *Curran, supra.* Futures contracts are usually formed without the expectation that the seller will make or the purchaser take actual delivery; they have standardized terms to facilitate their liquidation through offsetting transactions in a contract market; they involve the payment by both parties of "margin" deposits to secure future obligations; and they serve the primary purpose of shifting the risk of a change in the value of a cash commodity.[12] Those traditional elements must be applied, however, with sensitivity to the economic purposes of futures contracts as vehicles for hedging or speculating on price changes in the underlying cash market. As the CFTC and the courts have emphasized, "no bright-line definition or list of characterizing elements is determinative." *CFTC* v. *Co Petro Marketing Group, Inc.*, 680 F.2d 573, 581 (9th Cir. 1982); *In re Stovall*, [1977-1978 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,941, at 23,779 (1979) ("We do not mean that all commodity futures contracts must have all of these elements").

Against that background, the language of the CEA is properly interpreted to apply to IPs. Congress broadly vested the CFTC with "exclusive jurisdiction * * * with respect to * * * transactions involving contracts of sale of a commodity for future delivery[.]" 7 U.S.C. 2.[13] The term "future delivery" is expressly subject only to the limitation that it "shall not include any sale of any cash commodity for deferred shipment or delivery"; this provision was designed to exclude "forward contracts,"

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[12] See *CFTC* v. *Co Petro Marketing Group, Inc.*, 680 F.2d 573, 579-580 (9th Cir. 1982); *In re Stovall*, [1977-1978 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,941, at 23,777 (1979); *Policy Statement Concerning Swap Transactions*, 54 Fed. Reg. 30,694, 30,694-30,695 (1989) (CFTC release); 1 P. Johnson & T. Hazen, *Commodities Regulation* § 103, at 10-11 (2d ed. 1989); Gilberg, *Regulation of New Financial Instruments Under the Federal Securities and Commodities Laws*, 39 Vand. L. Rev. 1599, 1603 (1986).

[13] The term "contract of sale" is defined to include "sales, agreements of sale, and agreements to sell." 7 U.S.C. 2.

in which the parties contracting to sell a commodity actually expect to transfer the item, but, for reasons of convenience or necessity, postpone its delivery. 7 U.S.C. 2.[14] The term "commodity" is expansively defined to include "all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in." 7 U.S.C. 2.

IPs are "contracts of sale"; they obligate the seller to "deliver" the value of a stock index on a future date; and the value of that index constitutes a "right" or "interest" under the CEA's definition of commodity. Moreover, there is no meaningful sense in which IPs can be considered forward contracts that are excluded from the CFTC's jurisdiction under 7 U.S.C. 2; the parties to an IP contract are not engaged in a commercial venture to buy and sell securities in the "cash" market, with delivery being deferred for reasons of convenience. Rather, the very purpose of the IP is to provide a way to earn profits (or limit losses) from changes in the value of the stock index, without owning the underlying shares. As such, IPs serve the quintessential function of futures contracts in transferring the risk of price change without transferring title to (or making delivery of) the underlying commodity.[15]

In its order, the SEC declared that IPs lack the "futurity" necessary to a futures contract because "an

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[14] See H.R. Rep. No. 975, *supra*, 129-130; *In re Stovall*, [1977-1978 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,941, at 23,777-23,778; 1 P. Johnson & T. Hazen, *Commodities Regulation* § 1.03, at 9-10 (2d ed. 1989). In contrast, in a futures contract, the typical expectation is that the contractual obligations will be extinguished by entry into an equal and opposite transaction on the exchange. *In re Stovall*, *supra*.

[15] IPs also have other features that support their treatment as futures contracts. They have standardized terms in order to facilitate trading. They are essentially instruments by which traders may hedge against, or speculate on, changes in the value of a commodity, namely, the value of the index. And the interests created in IPs can be extinguished (and their value realized) by offset transactions involving the purchase (or sale) of an equal and opposite contract.

IP contract represents the *present* obligation to pay or right to receive the *current* value of an underlying portfolio of securities." Pet. App. 55 (emphasis in original). However, it is undisputed that the IP holder has only the right to compel delivery of the value of the index on the cash-out dates. Those dates, as the court of appeals pointed out, "lie[] in the future to the same extent as the settlement date of any futures contract." *Id.* at 17.

The general purposes of the CEA are also served by applying its provisions to IPs. Cf. *Crandon* v. *United States*, 110 S. Ct. 997, 1001 (1990) (looking to "design of the statute as a whole and to its object and policy" in interpreting statutory language). One of the basic functions of futures markets is to permit owners of commodities to establish "hedges" against the risk of loss in the underlying "cash" market. See S. Rep. No. 1131, *supra*, at 11-15; 7 U.S.C. 5; *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Curran*, 456 U.S. at 390. Congress recognized that purpose in providing for separate regulation of futures markets and cash markets, and it applied the principle of separate regulation specifically to trading in securities and futures contracts based on securities.[16]

As with other stock-index futures contracts, one function of IPs is to serve as hedges for a portfolio of stock: the contracts sold by the IP short increase in value when the net value of the securities in the underlying index declines. Consequently, the owner of securities (such as a portfolio manager of a pension fund) can seek to protect against falling prices in the securities markets by selling IPs. In designing its product, at least one stock exchange explicitly took account of the utility of selling

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[16] In connection with the 1982 Accord legislation, the Agriculture Committees of both the House and the Senate noted that "the CFTC will continue to retain its traditional role of regulating markets and instruments that serve a hedging and price discovery function while the SEC will primarily regulate markets and instruments with an underlying investment purpose." H.R. Rep. No. 626, *supra*, Pt. 2, at 3; S. Rep. No. 384, 97th Cong., 2d Sess. 22 (1982) (same); see also H.R. Rep. No. 565, 97th Cong., 2d Sess. Pt. 1, at 40 (1982) (same).

IPs as a hedge. See Pet. App. 30 (describing operation of CBOE's cash-out privilege when exercised by a "hedged [IP] short"). Because IPs permit the same type of hedging activity that characterizes the use of other futures contracts, it is consistent with Congress's purposes to allocate jurisdiction over IPs to the CFTC.[17]

Of course, the general allocation of hedging instruments to the CFTC is qualified by the fact that the SEC has jurisdiction to regulate options on securities (and on indices of securities), which also can be used as hedging instruments. See 15 U.S.C. 78c(a)(10); 15 U.S.C. 78i; H.R. No. 626, *supra*, Pt. 1, at 5 & n.8; Board of Governors of the Federal Reserve System, Commodity Futures Trading Commission, and Securities and Exchange Commission, *A Study of the Effects on the Economy of Trading in Futures and Options*, 98th Cong., 2d Sess. 31-48 (Comm. Print 1985). But the point remains that it accords with Congress's purposes (as well as the literal text of the CEA) to construe the CEA to cover IPs. Congress expected to have the CFTC (not the SEC) be the primary regulator of "contracts of sale * * * for future delivery of a group or index of securities (or any interest therein or based upon the value thereof)." 7 U.S.C. 2a(ii). There is, therefore, no anomaly in holding that IPs, which fall within the statutory description of the CFTC's jurisdiction and can play the classic hedging role of a futures contract, should be regulated as futures.

2. Noting the differences between IPs and conventional futures contracts, petitioners contend (as did the SEC in its orders) that IPs are distinguishable from the instru-

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[17] The Amex asserted in the court below that IPs could not be used for hedging because the short must deposit 150% of the value of the contract upon its formation and thus must "commit *an even greater* amount of cash * * * for his 'insurance' than he paid for his cash product." Amex C.A. Reply Br. 10-11 (emphasis in original); see 89-1502 Pet. 14 n.16. That statement overlooks the fact that the short receives 100% of the value of the IP upon its sale; thus, the IP short is required only to add to that sum half of the value of his "cash product"—a commitment that is compatible with hedging.

ments traditionally subject to CFTC jurisdiction. The principal differences between IPs and traditional futures contracts are that (a) the long pays the entire purchase price when the contract is established (so that the contract is executory only for the short and is not "bilateral"); (b) the long is entitled to receive quarterly dividend-equivalent payments, and (c) the contracts do not have a fixed expiration date. Congress, however, did not specifically require any of these elements in order to have a futures contract.

In particular, Congress did not require "bilateralism," the feature on which petitioners lay the most emphasis. 89-1502 Pet. 19; 89-1503 Pet. 13. Had Congress desired a bilateralism requirement, it could easily have made the CFTC's jurisdiction applicable only to "contracts of sale * * * for future delivery *and payment*"; this would have required both the short and long to perform in the future, as petitioners would have it. But, of course, Congress did not include the italicized language in the statute. The statutory focus on futurity is solely on the short's obligation to make delivery. Nor did Congress express an intention to restrict the concept of a futures contract to its historical antecedents. Likewise, the CFTC—the agency charged with administering the CEA—does not require a fixed list of elements to trigger the statute's application, but looks to economic substance. *In re Stovall*, *supra*.

In the analogous area of the federal securities laws, the Court has refused to be "bound by legal formalisms, but instead take[s] account of the economics of the transaction under investigation." *Reves* v. *Ernst & Young*, 110 S. Ct. at 949; see *Tcherepnin* v. *Knight*, 389 U.S. 332, 336 (1967); *SEC* v. *W.J. Howey Co.*, 328 U.S. 293 (1946); *SEC* v. *C.M. Joiner Leasing Corp.*, 320 U.S. 344 (1943). A similar interpretive approach is warranted, and has been employed, in construing the CEA. See *CFTC* v. *Co Petro Marketing Group, Inc.*, *supra*. Although the distinct features of IPs may, *to a holder*, make IPs resemble an interest in a portfolio of stock (or in a stock mutual fund), they do not alter the essential nature of the promise by the short. The fact remains that the IP

short agrees to deliver a commodity on a future date, and that is the key characteristic for coverage set forth in the CEA.[18]

In concluding that "bilateralism" was not essential in order to have a futures contract, the court of appeals relied on authority interpreting the CFTC's jurisdiction in the context of an enforcement proceeding, where a broad reading of the CEA serves to prevent harm to traders. Pet. App. 21, citing *CFTC* v. *Co Petro Marketing Group, Inc.*, *supra*. Contrary to views expressed to us by the SEC, we believe that reliance on such authority was appropriate in the context of this case.[19] The difference between enforcement proceedings and authorization of trading in a

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[18] None of the other differences between IPs and traditional futures contracts seems particularly essential to the instrument's classification. For example, "margin" in the IP context is said to regulate credit (as in stocks); it reflects the long's ability to use borrowed funds for the transaction. In the futures context, margin serves as a good-faith guarantee of future performance. The role played by margin in an IP, however, may be more a function of the intent to trade IPs as securities rather than an inherent attribute of the product. In any event, the purpose of requiring the IP short to deposit margin is to secure its future performance —a purpose that is fully consistent with the analysis of an IP as a futures contract.

The Amex IP permitted the long in certain circumstances to take physical delivery of stock rather than receive a payment representing the value of the index. A futures contract based on the value of an index of securities must be settled in cash, rather than by transfer of the underlying securities. 7 U.S.C. 2a(ii)(I). Rather than suggesting that the Amex IP is not a futures contract, however, the physical delivery feature makes the Amex IP a type of stock-index future that Congress did not intend to authorize.

[19] In the SEC's view, the broad construction given to the concept of a futures contract in the law enforcement context should not be applied in this case, where such a construction will defeat the SEC's jurisdiction over a particular instrument that the SEC has authorized for trading; the SEC believes that the legislative history of the CEA and, in particular, the "SEC savings clause," see pp. 20-23, *infra*, counsel against the application of the CEA to infringe on SEC jurisdiction.

new product should not change the definition of a futures contract.

It is true that this Court has noted that the question whether a particular instrument is a security requires consideration of "the content of the instruments in question, the purposes intended to be served, and the factual setting as a whole." *Marine Bank* v. *Weaver*, 455 U.S. 551, 560 n.11 (1982). That principle provides leeway for viewing an instrument to be a security in some, but not all, contexts.[20] The Court, however, has never embraced the principle that generalized notions of public policy could justify construing an agency's jurisdiction broadly in the enforcement context (in order to protect traders against fraud), yet narrowly in the regulatory context (in order to avoid suppression of a product that a sister agency believes would be useful and might not otherwise be brought to market). Such flexibility might advance what courts or agencies perceive to be good policy, but it would do so at the expense of Congress's chosen policy. Here, moreover, the treatment of the CFTC's jurisdiction in such a malleable fashion would effectively produce a zone of *concurrent* jurisdiction between the CFTC and SEC that Congress quite deliberately foreclosed (see pp. 21-22, *infra*).[21]

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[20] For example, *Marine Bank* held that certificates of deposits (CDs) insured by the FDIC were not "securities" on the facts before the Court. Subsequently, the Second Circuit held that a firm's program to obtain CDs for customers and to create a liquid market for their resale did create "securities" under the Exchange Act. *Gary Plastic Packaging Corp.* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 756 F.2d 230, 240-242 (1985) (viewing the arrangement as an "investment contract").

[21] A consistent interpretation of the CEA is also needed to avoid incongruous results. For example, under the SEC's "contextual" approach, the CFTC might have had power to assert exclusive jurisdiction over IPs if the SEC had not authorized their trading, but, given that the SEC had done so, the CFTC was ousted from exercising jurisdiction. We agree with the court below that "[e]ither IPs are futures contracts or they aren't";

The Court has sometimes found that coverage under the federal securities laws was not required because another scheme of regulation amply protected the parties in a particular setting.[22] It could be argued here that the jurisdiction of the CFTC should yield because a fully adequate scheme of regulation is available under the federal securities laws. Congress itself, however, determined that when the CEA and the securities laws both apply, the CEA's jurisdiction prevails. There is, therefore, no latitude for the creation of a new, non-statutory exemption from the CEA. See H.R. Conf. Rep. No. 1383, 93d Cong., 2d Sess. 35 (1974) (the CFTC's "jurisdiction over futures contract markets or other exchanges is exclusive" and "where applicable, supersedes State as well as Federal agencies").

Nor do we believe that the court of appeals erred in applying principles of deference to the agencies' interpretations of their statutes. In concluding that the CFTC had jurisdiction over IPs, the court of appeals assumed, without deciding, that both agencies were owed deference in construing their respective statutes to apply to IPs. Pet. App. 18-20. Under *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), an agency's reasonable interpretation of its governing statute is entitled to deference in areas where the statute is silent or ambiguous. We see no reason not to apply that principle to the statutory provisions here.[23] The SEC argued

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that determination cannot depend on which agency acts first in asserting jurisdiction. Pet. App. 22.

[22] See *Marine Bank*, 455 U.S. at 558 (certificate of deposit was not a security in part because of the scheme for regulation of that instrument under federal banking laws); *Teamsters* v. *Daniel*, 439 U.S. 551 (1979) (noncontributory, compulsory pension plan was not a security in part because of the scheme for regulation of the plan under ERISA).

[23] Principles of deference apply even though the issue of interpretation affects an agency's jurisdiction. See *CFTC* v. *Schor*, 478 U.S. 833, 845 (1986); cf. *Dole* v. *United Steelworkers*, 110 S. Ct. 929, 944 (1990) (White, J., dissenting) (citing cases); *Missis-*

in its rehearing petition, however, that the court's deference to the CFTC in this particular case was flawed because the court only accepted the CFTC's conclusion, while rejecting its rationale. SEC C.A. Reh'g Pet. 10-11, citing *SEC* v. *Chenery Corp.*, 318 U.S. 80 (1943). In particular, the SEC noted that the CFTC had urged that "bilateralism" was essential to find a futures contract, and, although the court of appeals agreed with the SEC that IPs lack bilateralism, Pet. App. 16, the court nonetheless purported to defer to the CFTC's bottom line that IPs were futures.

There are indeed passages in the CFTC's amicus curiae submissions to the court of appeals that, fairly read, characterize bilateralism as an essential aspect of a futures contract. CFTC C.A. Br. 8 (generally, in a futures contract "both parties to the contract are obligated to fulfill the terms of the contract at a specified price."); *id.* at 10 ("Besides futurity, IPs possess a second essential element of a futures contract: both parties to an IP are obligated to fulfill the contract at the specified price even though the contracts may be satisfied either by delivery or offset."). But clouding the issue is the fact that the CFTC found the element of "bilateralism" satisfied in this particular case. *Ibid.* The CFTC's understanding of that term, therefore, may not be wholly shared by the SEC and the court of appeals.

More fundamentally, this Court need not exercise its certiorari jurisdiction to decide whether the CFTC's process of reasoning was accurately understood by the court below. The CFTC did express the opinion that IPs are subject to its jurisdiction, and the language and purposes

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sippi Power & Light Co. v. *Mississippi ex rel. Moore*, 487 U.S. 354, 377 (1988) (Scalia, J., concurring). Here, of course, the jurisdiction of each agency depended on the characterization of an IP under the applicable statutes; the SEC asserted jurisdiction by interpreting the securities laws to apply to IPs, while the CFTC claimed jurisdiction by interpreting the CEA to apply to IPs. Under 7 U.S.C. 2, in such a case, the CFTC's jurisdiction prevails (provided the CFTC's interpretation is reasonable and consistent with its statute).

of the statute are consistent with that view. Moreover, other sources of the CFTC's thinking support the position that each element of a classic futures contract need not be present to invoke its jurisdiction; the touchstone is the economic purpose and overall nature of the instrument. See *CFTC* v. *Co Petro Marketing Group, Inc.*, *supra*; *In re Stovall*, *supra*. Accordingly, since the court of appeals correctly interpreted the CFTC's broader conclusions in this area, we do not believe that review of the issue of deference is necessary here.

The stock exchanges press the argument (89-1502 Pet. 19; 89-1503 Pet. 10) that "bilateralism" must be held essential to a futures contract in order to prevent the CEA's jurisdiction from sweeping in a host of other instruments whose value is realized in the future. For example, petitioners Amex, CBOE, and OCC claim that "options" cannot be distinguished from futures contracts absent bilateralism (89-1502 Pet. 19); petitioner Phlx makes the same claim about transactions in stock (89-1503 Pet. 10). Quite apart from the absence of a "bilateralism" requirement in the text of the statute, however, these arguments are unpersuasive.

Bilateralism is not the main distinction between options and futures. It is well recognized that the long in an option pays only a premium for the right to buy or sell the underlying interest; his exposure is accordingly limited to that sum. See N. Katzenbach, *An Overview of Program Trading and Its Impact on Current Market Practices* 7 (1987) ("The purchaser of the option, however, cannot suffer unlimited losses caused by movements in market price."). In contrast, the long in a futures contract has far greater exposure to loss resulting from price changes.[24]

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[24] Petitioners claim (89-1502 Pet. 18-20) that the court of appeals' analysis leaves no distinction between futures and options, but their method of reaching that conclusion is flawed. Petitioners isolate particular distinctions the court drew one-by-one, and claim that each is inadequate. Read as a whole, however, the court offered a concept of options as a distinct product offering "a careful balance among premium, strike price, and duration." Pet. App. 18.

As to the supposed need for bilateralism to distinguish stock transactions from futures transactions, it is sufficient to note that the seller and purchaser of stock in an ordinary exchange transaction intend to transfer the instrument, without any future contractual obligations. Economically, the sale of stock is purely a "cash" transaction; the typical five business days allowed for settlement does not detract from that characterization.[25] There is, therefore, no necessity to engraft a strict bilateralism requirement to distinguish the body of transactions traditionally covered by the securities laws from the type of instrument Congress intended to be regulated as a futures contract.[26]

2. In an effort to limit the coverage of the CEA, petitioners and the SEC have cited the provision in 7 U.S.C. 2 known as the "SEC savings clause." 89-1502 Pet. 21-22; 89-1503 Pet. 12 n.11; SEC C.A. Reh'g Pet. 5-8. That provision does not, in our view, justify limiting the CFTC's jurisdiction over IPs. The SEC savings clause appears immediately after the grant of exclusive jurisdiction to the CFTC over "contracts of sale * * * for future delivery" and states:

> *And provided further*, That, except as hereinabove provided, nothing contained in this section shall (i) supersede or limit the jurisdiction at any time conferred on the Securities and Exchange Commission

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[25] Cf. Op. CFTC Gen. Coun., No. 85-2 [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,673, at 30,856 (1985) (two business day settlement period "for purposes of administrative convenience or necessity" did not convert a precious metals transaction into a futures contract, on the particular facts).

[26] Petitioners point (89-1502 Pet. 20) to a variety of more complex transactions (such as "European-style options," "zero-coupon bonds," "index warrants," and "variable annuities") as examples of instruments that are claimed to exhibit the same degree of futurity as IPs, and whose classification is therefore called into question by the court of appeals' opinion. Those instruments were not involved in this case (or discussed by the court even in dicta), and review is not warranted to discuss abstract principles that might or might not apply to them in some other case.

> or other regulatory authorities under the laws of the United States or of any State, or (ii) restrict the Securities and Exchange Commission and such other authorities from carrying out their duties and responsibilities in accordance with such laws.

7 U.S.C. 2. The text of this provision sets forth no explicit substantive limitations on the CFTC's jurisdiction. Rather, its operative effect is expressly confined to provisions other than the CFTC's jurisdiction-granting language, which immediately precedes it. See Pet. App. 109.

Moreover, the legislative history of the SEC savings clause [27] does not indicate that the CFTC's jurisdiction over futures contracts should be read narrowly as applied to novel or unconventional products—which IPs surely are. That history reveals that Congress was particularly concerned with protecting the SEC's jurisdiction in its *traditional* areas of regulation. The history does not support the view that the concept of a "futures contract" should be given a narrow reading as applied to hitherto unknown financial products.

The original House bill provided both that the CFTC was to have exclusive jurisdiction over futures contracts and that nothing in the bill was to supersede the SEC's jurisdiction. H.R. 13113, 93d Cong., 2d Sess. § 201(B) (1974); H.R. Rep. No. 975, *supra*, at 3 (noting that SEC jurisdiction would be preserved "in those areas *traditionally* regulated by it") (emphasis added). The genesis of this provision was that prior to the 1974 amendments, regulation of trading in futures contracts was limited to specified agricultural commodities. The 1974 amendments proposed to expand the definition of "commodity" to cover any interest in which futures contracts were traded. To respond to the fact that "the expanded definition of 'commodity' * * * may include rights and interests which are

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[27] See generally Johnson, *The Commodity Futures Trading Commission Act: Preemption as Public Policy*, 29 Vand. L. Rev. 1, 7-19 (1976); Greenstone, *The CFTC and Government Reorganization: Preserving Regulatory Independence*, 33 Bus. Law. 163, 205-208 (1977).

securities as defined in the federal securities laws," the House Report explained that "except in the area of transactions involving a contract market, the jurisdiction of the [CFTC] is intended to exist *concurrently* with the jurisdiction vested in the [SEC]." *Id.* at 28 (emphasis added).

The Senate, however, rejected the notion of concurrent jurisdiction set forth in the House bill. In its Report, the Senate Committee indicated that it desired to give the CFTC *exclusive* jurisdiction "with regard to the trading of futures on organized contract markets," without "infring[ing] on the jurisdiction of the [SEC] or other government agencies." S. Rep. No. 1131, *supra*, at 23. Accordingly, the Senate added a new preface to the savings clause: "'[E]xcept as hereinabove provided,' nothing contained [in the section] shall supersede or limit the jurisdiction at any time conferred on the [SEC]." *Id.* at 31. The Report explained that the purpose of this amendment was to "clarif[y]" that the CFTC's "jurisdiction over futures contracts markets or other exchanges is exclusive," such that the CFTC's "jurisdiction, where applicable, supersedes State as well as Federal agencies." *Id.* at 6, 23. That language removed any overlapping jurisdiction between the CFTC and the SEC.

The Senate version on this point prevailed in conference. See H.R. Conf. Rep. No. 1383, *supra*, at 35-36 ("Under the exclusive grant of jurisdiction to the Commission, the authority in the Commodity Exchange Act (and the regulations issued by the Commission) would preempt the field insofar as futures regulation is concerned"). The purpose of the SEC savings clause was to clarify that the broadened definition of commodity "was not intended * * * to apply to trading in interests and rights traditionally known as securities, including, for example, stocks, corporate bonds, warrants, and debentures," but that the CFTC was authorized to exercise exclusive regulatory jurisdiction over the futures markets. 120 Cong. Rec. 34,737 (1974) (remarks of Rep. Poage); *id.* at 34,997 (remarks of Sen. Talmadge).

Interpreted in light of its history, the savings clause does not provide a basis for narrowing the CFTC's jurisdiction over novel instruments that fall outside of "traditional" SEC and CFTC domains. Congress did, of course, express an intention not to infringe on the SEC's jurisdiction over instruments it traditionally regulated. Indeed, the court of appeals recognized a similar principle. Pet. App. 14 ("if IPs are really 'stock,' they almost certainly are not 'futures contracts' "). But no such principle applies to IPs. Although the SEC's order reasoned that IPs are "stock" based on the analysis in *Landreth Timber Co.* v. *Landreth*, 471 U.S. 681 (1985), see Pet. App. 49-50, the court of appeals strongly suggested that IPs cannot be viewed as stock because they lack an issuing entity in which the holder owns an equity interest. *Id.* at 14-15. Although other terms in the statutory definition of "security" may very well apply to IPs, we share the court's doubts that IPs can be fit within the definition of "stock." [28] In any event, there is no evidence that "synthetic" securities such as IPs are what Congress had in mind when it drafted the SEC savings clause.[29] The savings clause is simply silent on the proper classification of such an instrument. To the extent that the IP is a novel instrument qualifying as both a "futures contract" and as a "security," the jurisdictional provisions call for exclusive regulation by the CFTC.

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[28] The Court in *Landreth* was concerned with describing the characteristics of "common stock" as found in an instrument that bears the name "stock." 471 U.S. at 681; *id.* at 688 (describing the instruments before it as "traditional stock"); see also *Reves* v. *Ernst & Young*, 110 S. Ct. at 950 ("common stock is the quintessence of a security"). IPs, of course, are not called "stock" and cannot be viewed as interests in a business enterprise in the sense that common stock is such an interest.

[29] Indeed, Congress has, since the 1974 amendments, rejected proposals by the SEC to remove futures trading in indexes of securities from the exclusive authority of the CFTC. See S. Rep. No. 850, 95th Cong., 2d Sess. 21-23 (1978) (accompanying CFTC reauthorization bill); *id.* at 22 (noting that Congress had recognized in 1974 that "futures markets would not remain static," and

3. Petitioners Amex, CBOE, and OCC contend (89-1502 Pet. 22-24) that the court of appeals erred in failing to hold that the SEC has jurisdiction over IPs pursuant to 15 U.S.C. 78i(g), which provides that "[n]otwithstanding any other provision of law, the [SEC] shall have the authority to regulate the trading of any put, call, straddle, option, or privilege of any * * * group or index of securities (including any interest therein or based on the value thereof)." Review of that question is not warranted because the SEC itself did not rely on 15 U.S.C. 78i(g) in its order permitting the trading of IPs. See *SEC* v. *Chenery Corp.*, 318 U.S. at 92-95.

The SEC canvassed a number of bases in 15 U.S.C. 78c(a)(10) in determining that IPs were "securities." The SEC found that IPs were "stock"; "certificate[s] of interest or participation in" stock; and "instrument[s] commonly known as a security." Pet. App. 47-53. The SEC also alluded to the possibility of analyzing IPs as receipts for interests in securities, or as investment contracts, which are also enumerated types of securities in the statutory definition. *Id.* at 48 n.47. In passing, the SEC stated that IPs had some characteristics that resemble features of "rights to purchase or puts or calls on a security or index of securities," but concluded that "IPs predominantly have the attributes of a portfolio of common stock." *Id.* at 52.[30] In the face of this survey, the lack of any plain statement that IPs might fall within 15 U.S.C. 78i(g) is a conspicuous omission. Indeed, the SEC did not rely on Section 78i(g) in its opening brief

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stating that "the basic conclusion reached in 1974 that there should be a single regulatory agency responsible for futures trading is as valid now as it was then"). Again, in 1983 when Congress enacted legislation to implement the SEC-CFTC jurisdictional accord, it confirmed that the CFTC had exclusive jurisdiction over futures contracts based on the value of an index of securities. 7 U.S.C. 2a(ii).

[30] The only option-like characteristics to which the SEC pointed were the cash-out and physical-delivery features of IPs. Pet. App. 52.

in the court of appeals. Not until its reply brief did the SEC inform the court that it accepted petitioners' view that Section 78i(g) applied; even then, the SEC qualified its position by stating "that the cash-out privilege in every IP (as distinguished from the IP itself) is an 'option or privilege' on an index, placing the IP within the statutory jurisdiction of the SEC." SEC C.A. Reply Br. 10-11.

Although the SEC is not foreclosed from considering the application of Section 78i(g) to IPs, this Court should not review that issue on the present record. The Court has frequently admonished that "Congress has delegated to the administrative official and not to appellate counsel the responsibility for elaborating and enforcing statutory commands." *Investment Company Institute* v. *Camp*, 401 U.S. 617, 628 (1971); *Securities Industry Ass'n* v. *Board of Governors*, 468 U.S. 137, 143 (1984 ("*post hoc* rationalizations by counsel for agency action are entitled to little deference"). Here, the SEC did not explicate the relationship of 15 U.S.C. 78i(g) to IPs in its administrative order or indicate that it based its action on that provision; consequently, this Court does not have the benefit of the considered analysis of the issue by the responsible agency.[31] Because the SEC should address the ramifications of applying Section 78i(g) to IPs in the first instance, review should not be granted to address that issue.[32]

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[31] The court of appeals (properly) did not decide the question either. The court indicated that "IPs convey privileges based on the value of an index" and thus the "closest match" in the definition of a security to an IP may be the language added in the Accord, Pet. App. 15, but it also expressed the view that IPs are not "options," *id.* 17-18.

[32] We note, without expressing a view on the matter, that applying Section 78i(g) to IPs raises questions that underscore the desirability of prior SEC consideration. Section 78i(g) was added to the securities laws to confirm the SEC's jurisdiction over stock index options. See H.R. Rep. No. 626, *supra*, Pt. 1, at 9, 12. It is unclear whether the word "privilege" in that section was intended to encompass a different type of interest from an "option,"

B. Petitioners contend that this Court's review is needed to alleviate the "quandary" facing participants in the financial markets regarding which system of regulation—that of the CFTC or SEC—will apply to innovative new products. 89-1502 Pet. 15; 89-1503 Pet. 6-7. In petitioners' view, the court of appeals' decision is so open-ended that it creates confusion over the tests for identifying a futures contract. This uncertainty, it is feared, will inhibit the development, approval, and marketing of new products in the Nation's financial sector. *Ibid.* Petitioners raise a concern—shared by the SEC—that such regulatory obstacles will impede the Nation's financial markets in international competition.[33] Although we do

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such as the IP holder's cash-out privilege. That interpretation would give to the term "privilege" a quite distinct connotation from the other terms listed in the section, a "put," "call," "straddle", or "option." Cf. *Dole* v. *United Steelworkers*, 110 S. Ct. 929, 935 (1990) ("The traditional canon of construction, *noscitur a sociis*, dictates that 'words grouped in a list should be given related meaning.'"). Furthermore, if the IP holder has a "privilege" on the index because of the cash-out feature, perhaps the same could be said of the long in a stock index futures contract; but that conclusion would conflict with the distinction between futures and options intended by Congress. Before these issues are addressed by this Court or any other, the SEC should be given a chance to articulate its views and explain the reasons supporting the application of Section 78i(g) to IPs.

[33] For example, petitioners state (89-1502 Pet. 15 n.18) that IPs are being traded on the Toronto Stock Exchange. (We understand that the Canadian product, the Toronto 35 Index Participations Units (TIPs), consists of units of a trust created by a stock exchange that holds, as underlying assets, the securities in the index. As such, these "units" are quite different from the contracts formed by the purchase and sale of IPs.) Reports have also circulated that a product bearing similarities to IPs will be offered in the United Kingdom. See *Citibank Plans UK Cash Basket Products*, Financial Times, Dec. 14, 1989.

We note, however, that the holding here allocating jurisdiction over IPs to the CFTC did not doom that product not to be traded; the CFTC proposed to cooperate with the SEC in authorizing the trading of IPs as futures contracts. See Statement of Dr. Wendy L. Gramm, Chairman, CFTC, Before the Securities

not minimize the importance of maintaining regulatory clarity, or the detrimental consequences that may flow from regulatory confusion, we do not believe that those problems can effectively be addressed by this Court's review of the question presented in this case.

To begin with, the Seventh Circuit's opinion need not be read, as petitioners fear, as a harbinger that the CFTC has jurisdiction to regulate any product with "an element of futurity," regardless of all other factors. 89-1503 Pet. 6; *id.* at 7 (finding flaws in the opinion when read with "the broadest possible scope"). The methodology of the court of appeals suggests otherwise. The court compared the particular characteristics of IPs to the recognized paradigms of futures contracts and securities; it acknowledged that IPs did not fit squarely within either model; but it ultimately found that IPs had every element of a financial futures contract save for "bilateralism." Pet. App. 21. Although the court refused to give the CEA a cramped reading that would effectively freeze the CFTC's jurisdiction to products known in 1974, the court did note that there are direct, substantial limitations on the concept of a futures contract. For example, the court made clear that products that are genuinely "stock" cannot be futures, Pet. App. 14, nor are products that are "options," *id.* at 18.

The court of appeals did not, of course, write a treatise to govern the categorization of all financial instruments, and some new hybrid or synthetic products will inevitably pose difficult problems of classification. But there is no reason to interpret the court's opinion as putting in doubt the settled regulatory treatment of a host of distinct financial products that were not at issue in that case.[34] In any event, petitioners' proposed limiting princi-

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Subcomm. of the Senate Comm. on Banking, Housing, and Urban Affairs 28-29 (Mar. 29, 1990) (describing proposals to authorize trading in IPs by cross-registration of securities account executives and futures associated persons).

[34] Indeed, the court was careful to reserve the question whether "an IP with a daily cash-out feature at no penalty" was a futures

ple—that the CFTC's jurisdiction should be defined principally by reference to "the types of futures contracts described in the legislative history that accompanied the enactment of the exclusive jurisdiction clause," 89-1502 Pet. 22—finds no support in the language or policies of the CEA, and would open the statute to ready evasion.

In the current, dynamic financial environment, the goal of achieving legal clarity, which petitioners—and the SEC—understandably desire, may prove elusive. Justice Holmes' admonition that "[c]ertainty generally is illusion, and repose is not the destiny of man" rings true in this area. Holmes, *The Path of the Law*, 10 Harv. L. Rev. 461, 466 (1897). "The boundaries of financial markets, from the demarcation between banking and investing to the presumably slighter distinction between any two given instruments, defy precise delineation." N. Katzenbach, *supra*, at 3. Indeed, prior to the decision in this case, commentators noted the difficulty in drawing lines between the CFTC and SEC's authority in view of the proliferation of new and complex financial instruments.[35] To the extent that such ambiguities are inherent in the statutes, however, predictable tests are likely to be achieved only through development of the case law, the issuance of administrative regulations, or congressional action. Earlier this Term the Court remarked, in explicating the meaning of the term "note" under the federal securities laws, that "[o]ne could question whether, at the expense of the goal of clarity, Congress overvalued the goal of avoiding manipulation by the clever and dishonest. If Congress erred, however, it is for that body, and not this Court, to correct its mistake." *Reves* v.

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contract. Pet. App. 110. That reservation demonstrates not the "illogic" of the court's position (see 89-1503 Pet. 9), but its restraint. The reservation of the proper legal status of a product with such a minute difference from the IPs before the court underscores the limited nature of the court's holding.

[35] See Gilberg, *supra*, 39 Vand. L. Rev. at 1686 (noting the "definitional ambiguities in the law" and pointing out that the "question of which of the two agencies has jurisdiction over a specific product is very often itself unclear").

Ernst & Young, 110 S. Ct. at 950 n.2. A similar point well applies, in our view, to the statutory concept of a futures contract.[36]

Recognizing the potential for uncertainty, the CFTC has sought to provide detailed guidance to the financial community with respect to the scope of its jurisdiction in certain areas. See *Regulation of Hybrid Instruments*, 54 Fed. Reg. 1128 (1989) (proposed rules); 54 Fed. Reg. 30,684 (1989) (final rules); *Policy Statement Concerning Swap Transactions*, 54 Fed. Reg. 30,694 (1989); *Statutory Interpretation Concerning Certain Hybrid In-*

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[36] Congressional committees are currently exploring the policy issues raised by the allocation of jurisdiction between the CFTC and the SEC, including issues raised by this case. Hearings were held before the Securities Subcommittee of the Senate Committee on Banking, Housing, and Urban Affairs on March 29, 1990, the House Committee on Agriculture on May 8, 1990, and the Telecommunications and Finance Subcommittee of the House Committee on Energy and Commerce on May 24, 1990. At those hearings, the Chairmen of the SEC, CFTC, and the Federal Reserve Board, as well as the Under Secretary of the Treasury for Finance, testified regarding the broader issues stemming from the division of authority between the CFTC and SEC, and the narrower issue whether the regulation of stock index futures should be transferred from the CFTC to the SEC. Under Secretary Robert R. Glauber stated in his May 8, 1990, statement to the Senate Agriculture Committee (at p. 10) that "[r]egulatory competition also begets jurisdictional squabbles, which can strangle innovation. New products are not merely stifled; they quickly move to overseas markets."

Several bills are pending in Congress that deal with these issues. See H.R. 3662, 101st Cong., 2d Sess. (1989) (intended to transfer jurisdiction over stock index futures to the SEC); H.R. 4477 (intended to consolidate regulation of securities and futures in a single agency); S. 2335 (intended to require appointment of one SEC commissioner to CFTC and one CFTC commissioner to SEC) (both in 101st Cong., 2d Sess. (1990)). The issue is receiving high-level attention under the aegis of the President's Working Group on Financial Markets, consisting of representatives of the SEC, CFTC, Federal Reserve Board, and the Treasury Department. On May 8, 1990, the Secretary of the Treasury advised the Senate Agriculture Committee of the Administration's support for a bill that would, among other things, shift regulatory authority for stock index futures to the SEC and modify the CEA's "exclusivity" clause.

struments, 55 Fed. Reg. 13,582 (1990) (regarding instruments that combine characteristics of futures contracts or commodity options with debt or certain equity interests). The issuance of these statements reflected the CFTC's recognition that "the proliferation of hybrid instruments incorporating futures or commodity option elements in innovative formats has caused uncertainty as to the regulatory status of such instruments." The rules proposed by the CFTC were thus intended "to ensure that existing regulatory structure[s] do not unnecessarily retard growth or innovation or fail to provide protections that are responsive to market developments." 54 Fed. Reg. 1128 (1989). Although the CFTC's statements do not purport to address all interpretive questions under the CEA, they diminish somewhat the need for the judiciary to take on the unaccustomed role of furnishing comprehensive answers in this area.

In sum, the proper interpretation of the CFTC's jurisdiction is an important question that this Court has not had an occasion to address.[37] We believe, however, that the question was answered correctly below. The many issues that lie beyond the periphery of this case do not require this Court's present attention.[38]

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[37] Indeed, the courts of appeals have had comparatively few opportunities to interpret the CEA in this context. See 89-1502 Pet. 11 (characterizing issues presented as "a matter of first impression"). For IPs, however, the court of appeals' decision is in effect a national precedent; the reversal of the SEC's order precludes the further marketing of the product as a security. We note that this aspect of the SEC/CFTC controversy may give the Seventh Circuit a disproportionate influence over the development of this field of law. For historic reasons, Chicago is home to many of the nation's futures exchanges, and those parties can therefore bring their challenges to SEC orders in the Seventh Circuit, as they did here. See 15 U.S.C. 78y. Circuit conflicts may accordingly be slow to develop.

[38] As to the ICI's "conditional" petition for certiorari, we believe that the Court should deny it as well. If the Court grants the petitions for certiorari in Nos. 89-1502 and 89-1503, the ICI petition should be held for disposition in light of those cases. The court of appeals never addressed the question whether IPs are governed by the Investment Company Act, and this Court would be benefitted by the airing of those issues in that court as an initial matter.

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted.

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1989

No. 89-1502
AMERICAN STOCK EXCHANGE, INC., ET AL.,
Petitioners,
v.
CHICAGO MERCANTILE EXCHANGE, ET AL.,
Respondents.

No. 89-1503
PHILADELPHIA STOCK EXCHANGE, INC.,
Petitioner,
v.
CHICAGO MERCANTILE EXCHANGE, ET AL.,
Respondents.

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

JOINT REPLY OF PETITIONERS TO BRIEFS IN OPPOSITION

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Respondents.

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

JOINT REPLY OF PETITIONERS TO BRIEFS IN OPPOSITION

The petitioners in No. 89-1502, American Stock Exchange, Inc., Chicago Board Options Exchange, Incorporated and The Options Clearing Corporation, and the petitioner in No. 89-1503, Philadelphia Stock Exchange, Inc., submit this joint reply to the briefs in opposition filed by the Solicitor General "for the federal respondent" ("S.G. Br.") and by respondents Chicago Mercantile Exchange and Board of Trade of the City of Chicago ("CME/CBT Br.").[1]

ARGUMENT

A. The brief in opposition filed by the Solicitor General shows that the issues presented by this case loom large in the administration of two federal regulatory schemes. The brief states that the proper resolution of these issues "is important to regulators, to the financial markets subject to their jurisdiction, and to the interpretation of the two statutory schemes in question." (S.G. Br. 7.) It notes that, in the view of the SEC[2]—the agency of the United States which is the federal respondent in this case[3]—the holding of the court of appeals "is wrong and its underlying analysis creates a climate of uncertainty about the proper boundaries between [the SEC's] jurisdiction and that of the CFTC" and that this "will harm financial innovation, capital markets, and investors." (*Id.* 7–8.) The brief further notes that the SEC shares the petitioners' concern that the confusion and uncertainty created by the court of appeals' decision "will inhibit the development, approval, and marketing of new products in the Nation's financial sector" and that this "will impede the Nation's financial markets in international competition." (*Id.* 26.) The brief makes clear that the issues involved are sufficiently important to receive "high-level attention under the aegis of the President's Working Group on Financial Markets," as well as the attention of a number of Congressional committees, and it notes that the Adminis-

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[1] The lists included at p. ii of the petitions for a writ of certiorari in Nos. 89-1502 and 89-1503 pursuant to Rule 29.1 of the Rules of this Court remain currently accurate.

[2] The abbreviations used in this reply brief are the same as those used in the petition in No. 89-1502.

[3] The brief is captioned "Brief for the Federal Respondent in Opposition," even though the SEC is the only federal respondent, the brief is not signed by any of the SEC's attorneys, and it is plain on the face of the brief that the SEC believes that certiorari should be granted. (S.G. Br. 8.)

tration believes that jurisdictional squabbles of the kind involved in this case " 'can strangle innovation. New products are not merely stifled; they quickly move to overseas markets.' " (*Id.* 29, n.36, quoting the statement of Robert R. Glauber, Under Secretary of the Treasury for Finance, before the Senate Agriculture Committee on May 8, 1990.) Finally, it states in summation that "the proper interpretation of the CFTC's jurisdiction is an important question that this Court has not had an occasion to address." (S.G. Br. 30.)

The Administration and the SEC also have stressed the importance of the issues presented here in their testimony before Congress. For example, in his May 8, 1990 statement to the Senate Agriculture Committee, Under Secretary Glauber, expressing the Administration's views, noted that the result of the court's current interpretation "has been protracted litigation over what constitutes a 'future'; an inability to trade in the U.S. markets most suited to the product; and the shifting of business to more hospitable overseas markets. This is precisely what happened to Index Participation Certificates, which now trade in Toronto rather than the United States." (Statement of Robert R. Glauber, Under Secretary of the Treasury for Finance, before the U.S. Senate Committee on Agriculture, Nutrition, and Forestry, May 8, 1990, at 10.) Similarly, in recent Congressional testimony, Chairman Breeden testified that as a result of the court of appeals' decision "it is most unlikely that any U.S. securities exchange will trade, or any corporate issuer will issue, any new security that may even be argued to include any element of a futures contract" and that the decision "could do incalculable damage to the U.S. securities markets." (Testimony of Richard C. Breeden, Chairman of the SEC, before the Subcommittee on Securities of the Committee on Banking, Housing, and Urban Affairs, March 29, 1990, at 7.) It is thus plain that the questions presented are viewed by the Administration and the SEC as being of great importance to the regulation, competitiveness and development of the Nation's markets.[4] The Solicitor General's brief does not basically disagree with these conclusions.

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[4] On June 5, 1990, the Department of the Treasury transmitted the Administration's legislative proposal to Congress. The proposal con-

(Footnote continued on following page)

B. Under the statutory scheme governing the regulatory authority of the SEC and the CFTC, the SEC (and not the CFTC) has been given jurisdiction "to regulate the trading of any put, call, straddle, option or privilege on any . . . group or index of securities (including any interest therein or based on the value thereof)," and the CFTC (and not the SEC) has been given jurisdiction with respect to "transactions involving . . . contracts of sale (or options on such contracts) for future delivery of a group or index of securities (or any interest therein or based upon the value thereof)." Section 9(g) of the Exchange Act, 15 U.S.C. § 78i(g); Sections 2(a)(1)(B)(i) and (ii) of the CEA, 7 U.S.C. §§ 2a(i) and (ii). Further, if a transaction involves a "security" but not a futures contract, then it is subject to the regulatory jurisdiction of the SEC under the securities laws. The word "security" is a defined term in the Exchange Act and the other federal securities laws, and it has also been the subject of considerable interpretation by this Court. *See, e.g., Reves v. Ernst & Young,* 110 S.Ct. 945, 948–52 (1990); *Marine Bank v. Weaver,* 455 U.S. 551, 555–56 (1982); *Tcherepnin v. Knight,* 389 U.S. 332, 335–40 (1967). On the other hand, the other terms used as the basis for allocating regulatory jurisdiction—"option," "privilege," and "contracts of sale for future delivery"—have no statutory definition, and their meanings have never been decided or settled by this Court.

1. The definition of "contracts of sale for future delivery" (or "futures contracts") has proved to be an elusive one. The court of appeals decision and the Solicitor General's brief in this case are breaking new ground when they reject bilateralism as an essential element of a futures contract. The CFTC's brief before the court of appeals refers to bilateral obligations as an

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[4] *continued*
tains a provision that is intended by the Administration to overrule the court of appeals' decision in this case because the "result of this decision . . . has been to impede the development of innovative financial instruments that may have some aspect of futurity." (*See* Letter from Jeanne S. Archibald, Acting General Counsel of the Department of the Treasury, to Dan Quayle, June 5, 1990, enclosing Section-by-Section Analysis of proposed legislation, at 10.)

"essential element of a futures contract." (CFTC App. Br. 10; S.G. Br. 18.) Similarly, when the Solicitor General petitioned for a writ for certiorari on behalf of the SEC in *SEC v. Board of Trade of the City of Chicago, et al.*, No. 82-526, he stated:

> Unlike an option, a futures contract is an executory sales contract, involving a promise to deliver and a promise to take delivery and make payment at some time after the contract is formed.

(S.G. Pet. in No. 82-526, at 18, n.18.) This definition—which includes bilateral obligations of both buyer and seller—conforms with those supplied by commentators. *See, e.g.*, Gilberg, *Regulation of New Financial Instruments Under the Federal Securities and Commodities Laws*, 39 Vand. L. Rev. 1599, 1603 (1986); 1 P. Johnson & T. Hazen, *Commodities Regulation*, § 103, p. 10 (2d ed. 1989). Thus, both the court of appeals' decision and Solicitor General's brief reject earlier views as to how to define a futures contract. They both give great deference to the conclusions of the CFTC (but not the reasoning) that IPs are futures contracts (App. 22-24; S.G. Br. 17-18), but they provide little guidance as to why one instrument should be deemed to be a "futures contract" and another not.

2. The case of *CFTC v. Co Petro Marketing Group, Inc.*, 680 F.2d 573 (9th Cir. 1982), was cited by the court of appeals as authority for its finding that bilateralism was not an essential element of a futures contract (App. 21), and this citation is supported by the briefs in opposition. (S.G. Br. 15; CME/CBT Br. 11-12.)[5] However, the contracts in *Co Petro* were in fact bilateral, as both parties were obligated to perform at a specified future date even though the buyer's financial obligation was limited by a liquidated damages clause. *Co Petro*, 680 F.2d at 576. It is therefore inaccurate to speak of *Co Petro* as authority for the elimination of bilateralism as an essential element of a futures contract.

[5] The *Co Petro* decision, which respondent futures exchanges note is the *only* other appellate case addressing these issues (CME/CBT Br. 12), was rendered by a divided court. The dissenting judge stated: "There is an indication that Congress intended . . . to regulate the sale of 'futures' *as that term is used in the trading markets of the nation*." *Co Petro*, 680 F.2d at 587 (Smith, J., dissenting; emphasis supplied).

Clearly, the CFTC did not think of *Co Petro* as such authority when it filed its brief with the court of appeals.

3. In concluding that IPs are futures contracts, the Solicitor General's brief places significant emphasis on the conclusions that a function of the futures markets is to permit hedging and that one function of IPs is to serve as a hedge. (S.G. Br. 12-13.) There are two deficiencies with this argument. First, the SEC never found that IPs would function as hedging instruments.[6] Instead, it found that IPs had the economic characteristics of other securities and that IPs would provide retail investors with a means "to invest in 'the market.' "[7] (App. 47-53, 69.) Accordingly, the Solicitor General is supplying a finding that the SEC did not make.[8] Second, as the Solicitor General recognizes (S.G. Br. 13), securities options can and are used as hedging instruments. In addition, other types of securities—*e.g.*, warrants and convertible stocks and bonds—can also be used as hedging instruments. Thus, even if IPs could be used secondarily for hedging purposes, this would not serve as a principled basis for treating them as futures contracts for jurisdictional purposes.

4. The Solicitor General's reading of the legislative history is flawed. (S.G. Br. 20-23.) The brief quotes a Congressional statement that SEC jurisdiction would be preserved "in those areas traditionally regulated by it" (S.G. Br. 21) and concludes that only traditional securities, such as stocks, remain free from the jurisdictional inroads of the CFTC. Apart from the fact that this conclusion ignores other relevant statements by Congress,[9] it reads what Congress said too narrowly. IPs were designed to be marketed, traded on national securities exchanges and cleared

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[6] *See* petition in No. 89-1502, at 14, n.16.

[7] That was essentially the reason why the Investment Company Institute argued that IPs are investment company shares. (App. 37.)

[8] The Solicitor General reached his conclusion based on a belief by CBOE that a feature of its form of IP would assist shorts who wished to hedge. (S.G. Br. 12-13; App. 30.) However, this feature was not included in the IPs traded on AMEX and PHLX and therefore cannot properly be used as a general basis for allocating jurisdiction.

[9] For example, the petition in No. 89-1502 noted that Congress had described the exclusive jurisdiction clause as applying to the trading of

(Footnote continued on following page)

like options and other securities, and it was certainly within the SEC's "traditional area of regulation" to regulate the trading of those instruments in the same manner that it regulated other securities. (Pet. in No. 89-1502, at 5-6.) That the SEC was acting in its traditional area of regulation was emphasized by the Chairman of the SEC, in a letter to Congress explaining why the SEC did not agree with a compromise suggested by the CFTC to consider cross-registration of securities brokers under CFTC rules if IPs were traded on futures exchanges. Among other things, the Chairman said that:

> the Commission believes that the securities regulatory system, which has a primary emphasis on retail investor protection, is ideally suited for IPs. In approving IPs, the Commission concluded that IPs might be of substantial interest, not only to institutional investors, but also to retail investors as a lower cost means of obtaining the economic equivalent of an investment in a portfolio of stock. In part because of the expected retail interest in the product, the Commission concluded that the regulatory protections for retail investors in place for the securities markets should be applied to IPs.

(Letter from David S. Ruder, Chairman of the SEC, to Senators Patrick Leahy and Richard Lugar, May 22, 1989, at 2–3; footnotes omitted.) On the other hand, IPs were not designed to be marketed, traded or cleared in the manner traditionally applicable to futures contracts, and petitioners believe that IPs could not be successfully marketed and traded in such manner.[10]

The Solicitor General misunderstands Congress' use of the word "traditionally." Congress said "*areas* traditionally regulated by it," but the Solicitor General shifts this to "*instruments* it

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[9] *continued*
"futures on organized contract markets," and that it had said that, with that exception, it did not wish to infringe on the jurisdiction of the SEC. (Pet. 16.)

[10] *See* Statement of Wayne P. Luthringshausen, Chairman of the Board of OCC, before the Subcommittee on Telecommunications and Finance of the House of Representatives Committee on Energy and Commerce, May 24, 1990, at 9–10; Testimony of James R. Jones, Chairman, AMEX, before the House Subcommittee on Telecommunications and Finance, May 24, 1990, at 9–10.

traditionally regulated." (S.G. Br. 21–23; emphasis supplied.) There is nothing in the legislative history to suggest that Congress intended to freeze the SEC's jurisdiction to the group of instruments that were regulated by it prior to 1974 or that the SEC was not to be the federal regulator of new forms of investment. On the other hand, there is nothing in the court of appeals decision or in the CFTC's release to suggest that "traditional" securities having an element of "futurity" may not be held to be subject to the CFTC's exclusive jurisdiction.[11] As is shown by a recent release relating to hybrid instruments, the CFTC believes that its jurisdiction could extend to certain bonds, preferred stocks and equities. *Regulation of Hybrid Instruments,* 54 Fed. Reg. 30684, 30684–85 (1989).

5. As discussed in the petition in No. 89-1503, the court of appeals determined that the CIP possessed "futurity" despite the fact that the CIP gave an investor the right to realize the value of his investment on a *daily* basis. (Pet. 9–11). The court noted that the daily cash-out provided for the payment of 99.5% of the value of the underlying index, rather than 100%, and reserved decision on an instrument providing for 100% cash-out. (App. 27–28.) The Solicitor General argues that the court's reservation on an instrument that differs to only a "minute" degree evidences the "limited nature of the court's holding." (S.G. Br. 27–28, n. 34.) However, neither the court nor the Solicitor General offers a reasoned basis for distinguishing between two fundamentally identical instruments that differ only by 0.5% of economic value. Instead of illustrating that the holding was limited, the court of appeals' treatment of the daily cash-out illustrates the confusion its decision engenders.

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[11] The Solicitor General's brief implies that the TIPs being traded on the Toronto Stock Exchange may not be futures contracts because they are backed by units of trust that hold the securities in the index. (S.G. Br. 26, n.33.) It is hard to see how this would make a difference under the Solicitor General's "key characteristic" test (S.G. Br. 14–15), since the short is required to deliver at a future date whether or not the underlying securities are held in trust. Thus, rather than clarifying matters, the Solicitor General's test has extended the reach of the definition of "futures contract" to embrace such traditional investment company securities as units of trust.

6. Petitioners in No. 89-1502 argued that one of the important jurisdictional provisions adopted by Congress in 1982—Section 9(g) of the Exchange Act, 15 U.S.C. §78i(g), which vested the SEC with jurisdiction to regulate the trading of any "privilege on any . . . group or index of securities (including any interest therein or based on the value thereof)"—was not considered by the court of appeals even though the court had noted that "IPs convey privileges based on the value of an index." (Pet. 22–24.) The Solicitor General does not comment on the merits of this argument; instead he contends, citing *SEC v. Chenery Corp.*, 318 U.S. 80, 92–95 (1943), that review of the question is not warranted because the SEC did not rely in its order on Section 9(g).[12] (S.G. Br. 24–25.)

Chenery involved a "determination of policy or judgment which the agency alone is authorized to make and which it has not made" and not a determination of jurisdiction. 318 U.S. at 88. When it next took up the Chenery matter, the Court said:

> a reviewing court, in dealing with a determination or judgment which an administrative agency alone is authorized to make, must judge the propriety of such action solely by grounds invoked by the agency. If those grounds are inadequate or improper, the court is powerless to affirm the administrative action by substituting what it considers to be a more adequate or proper basis. To do so would propel the court into the domain which Congress has set aside exclusively for the administrative agency.

SEC v. Chenery Corp., 332 U.S. 194, 196 (1947). Certainly, a determination as to whether an agency has jurisdiction is not a determination that "an administrative agency alone is authorized to make." The *Chenery* principle does not apply to determinations by an agency of its own jurisdiction, and an agency does not lose jurisdiction conferred by statute by failing to assert all of the bases for exercising it.[13]

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[12] However, as the petition in No. 89-1502 notes (Pet. 23, n.32), the analysis in the SEC's order is not inconsistent with reliance on Section 9(g).

[13] In this case, the CFTC stated that it had jurisdiction for reasons that were not accepted by the court of appeals. The court of appeals and the

(Footnote continued on following page)

Further, even if the *Chenery* doctrine were applicable to agency determinations of jurisdiction, the court of appeals should have remanded the proceeding to the SEC for its determination as to the applicability of Section 9(g). *See, e.g., FTC v. Sperry and Hutchinson Co.*, 455 U.S. 233, 249–50 (1972) (modified court of appeals' reversal of agency order to require a remand to the agency for its determination whether to apply the alternate rationale offered in support of its order). It would therefore be appropriate, if the Court did not wish to decide this issue on the merits at this stage, for the Court to grant certiorari and to modify the court of appeals reversal so as to require a remand to the SEC on this issue.[14]

7. The respondent futures exchanges argue that IPs are not options or privileges. (CME/CBT Br. 14–16.) In doing so, they rely on a 1926 case and a 1936 remark of a Senator to provide a definition of a word used by Congress in a 1982 enactment designed to make it certain that the SEC would have jurisdiction to regulate transactions in "any" option or privilege. The futures exchanges thus want to have it both ways: they want "futures contract" to be defined in a way that has no relationship to any traditional use of the term and to be expandable as the need arises,[15] and, at the same time, they want to limit the definitions of "option" and "privilege," as used to fix the jurisdiction of the SEC, to 50-year old usages in the commodity markets. Clearly, Congress intended a more evenhanded treatment. The question as to how these jurisdictional words should be defined remains an open one that, we believe, is important for this Court to examine.

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[13] *continued*
Solicitor General are prepared to accept the CFTC's bottom-line conclusion, but not its reasoning, notwithstanding *Chenery*. There is no reason to apply a different standard to the bottom-line conclusion of the SEC.

[14] The Solicitor General says that the SEC is not foreclosed from considering the application of Section 9(g) to IPs. (S.G. Br. 25.) However, in the absence of a remand, it is difficult to see how it would be possible for the SEC to open up this issue.

[15] The futures exchanges argue that the court of appeals found IPs to be futures contracts because "(1) an IP's value depended upon the on-

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C. The respondents argue that this Court should leave it to Congress to correct any mistaken holding by the court of appeals. (S.G. Br. 28–29; CME/CBT Br. 18–19.) However, the pendency or possibility of a legislative solution should not deter the Court from granting certiorari. In the absence of legislative action, the agencies and the public must look to the courts for final resolution of conflicting statutory interpretations of existing laws. If the Congress should enact legislation overruling the decision of the court of appeals, the Court will be able to vacate the judgment as moot. If, on the other hand, Congress does not act, it remains important for this Court to settle the important jurisdictional questions involved.

CONCLUSION

The petitions for a writ of certiorari in Nos. 89-1502 and 89-1503 should be granted.

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[15] *continued*
going market assessment of the value that the stock index would have on a 'prescribed' or 'defined' future date . . . and (2) IP's do not convey an ownership interest in the stock in the index." (CME/CBT Br. 11.) This not only departs from the reasons advanced by the Solicitor General (S.G. Br. 14–15), but it also ignores that the value of virtually all securities (other than common stocks, which, like IPs, have a perpetual existence) depends on assessments of value of the underlying assets or obligations at a prescribed future date, and that Congress adopted Section 9(g) and amended Sections 3(a)(10) and 28(a) of the Exchange Act to allow for securities which are based on the value of an underlying index and which do not convey an ownership interest in the securities in the index. *See* H.R. Rep. No. 626, 97th Cong., 2d Sess., pt. 1 at 9, *reprinted in* 1982 U.S. Code Cong. & Admin. News 2780, 2787.

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